FILE COPY

SUPPLEMENTAL TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1960

No. 288

AMERICAN AUTOMOBILE ASSOCIATION,
PETITIONER,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED AUGUST 2, 1960
CERTIORARI GRANTED OCTOBER 10, 1960

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

No. 288

AMERICAN AUTOMOBILE ASSOCIATION,
PETITIONER,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

INDEX

	Original	Print
Additional proceedings in the United States Court of Claims		
Testimony for plaintiff	1	1
Appearances	1	1
Opening statement on behalf of plaintiff	2	2
Testimony of Frederick M. Blum—		
direct	9	6
cross	18	11
redirect	25	16
recross	31	19
Arthur I. Cooper—		
direct	33	21
cross	53	33
redirect	59	37
recross	60	37

RECORD PRESS, PRINTERS, NEW YORK, N. Y., DECEMBER 15, 1960

	Original	Print
Additional proceedings in the United States Court of Claims—Continued		
Testimony for plaintiff—Continued		
Testimony of William A. Paton—		
direct	61	38
cross	83	52
redirect	95	60
recross	97	62
George E. Baker—		
direct	99	63
cross	101	64
redirect	105	67
S. Alexander Bell—		
direct	105	67
cross	112	71
redirect	112	71
Herbert T. McAnly—		
direct	113	72
Arthur I. Cooper— (recalled)—		
direct	122	78
Plaintiff's Exhibit 1—Schedule showing pre-paid dues received, deferred revenue membership dues, and percentage, for the years 1949 through 1953	126	80
Plaintiff's Exhibit 2—American Automobile Association—Monthly costs and expenses, five years 1948-1952	127	81
Plaintiff's Exhibit 3—American Automobile Association—Deferred revenue—membership dues at December 31, 1953 based on cost percentages for five years, 1948-1952	128	82
Plaintiff's Exhibit 4—American Automobile Association—Monthly costs and expenses five years 1949-1953 (divisions only)	129	83
Plaintiff's Exhibit 5—American Automobile Association—Deferred revenue—membership dues at December 31, 1954 based on cost percentages for five years, 1949-1953	130	84

	Original	Print
Additional proceedings in the United States Court of Claims—Continued		
Plaintiff's Exhibit 6—American Automobile Association Year 1953, Deferred revenue—membership dues based on average monthly costs per member	131	85
Plaintiff's Exhibit 7—American Automobile Association Year 1954, Deferred revenue—membership dues based on average monthly costs per member	132	86
Plaintiff's Exhibit 8—Data regarding training and experience of William A. Paton	133	87
Cross-designation of parts of record to be printed	140	99

[fol. 1]

IN THE UNITED STATES COURT OF CLAIMS

No. 311-58

AMERICAN AUTOMOBILE ASSOCIATION, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant.

Washington, D. C.,
Monday, November 24, 1958.

Testimony for Plaintiff

The parties met, pursuant to notice of the Commissioner, at the time above stated, in Hearing Room No. 1, United States Court of Claims.

Present:

Hon. Marion T. Bennett, Commissioner.

APPEARANCES

Fleming Bomar, Esq., and Joseph E. McAndrews, Esq., Counsel for the Plaintiff.

William T. Kane, Esq., Counsel for the Defendant.

(The reporter, D. F. King, was first duly sworn by said Commissioner.)

[fol. 2] Commissioner Bennett: Gentlemen, we are prepared to hear the evidence in the case of the American Automobile Association against the United States. Plaintiff's counsel is recognized. Do you wish to make an opening statement?

Mr. Bomar: Yes, Your Honor.

First, Your Honor, we have here the agreed stipulation of facts which I offer for submission and the attached exhibits referred to in the stipulation.

Commissioner Bennett: The exhibits are in the folders?

Mr. Bomar: In the folders, yes, sir.

Commissioner Bennett: Without objection the stipulation and seven accompanying exhibits are received into evidence and may be marked as Joint Exhibits Nos. 1 through 8.

(Stipulation with seven attached Exhibits were marked Joint Exhibits Nos. 1 through 8 and received in evidence.)

OPENING STATEMENT ON BEHALF OF THE PLAINTIFF

Mr. Bomar: May it please the Court, Plaintiff is a membership corporation without stock of any kind and seeks a refund of a part of the Federal income taxes which it has paid for the calendar years 1952 and 1953. The calendar year 1954 is also involved in this proceeding because the Plaintiff incurred a substantial loss during the calendar year 1954, or, Plaintiff contends that it did, which gives rise [fol. 3] to an operating loss carryback deduction to the calendar years 1952 and 1953.

The Federal income taxes in issue total $195,277.81.

Only one issue is involved in this case and that is whether Plaintiff's method of accounting for prepaid dues received from members of its ten divisions, clearly reflects Plaintiff's net income. Plaintiff contends that its method of accounting is in accord with generally accepted accounting principles and clearly reflect its net income, and accordingly under the statute must be accepted for tax purposes. Under Plaintiff's method of accounting, dues paid in advance for twelve months by members of its divisions are not recognized as income entirely in the year of receipt but, instead, are recognized as gross income ratably over the period of time that Plaintiff is obligated to render services to its members, whether or not such period extends beyond the close of Plaintiff's taxable year. Plaintiff contends that prepaid dues are in advance from members which cannot be recognized as gross income until services are rendered, or made available.

The Commissioner of Internal Revenue has ignored Plaintiff's method of accounting and has substituted a method of his own under which all advance dues are recog-

nized as income in the calendar year of receipt, irrespective of the fact that Plaintiff is obligated to render services over [fol. 4] a period of time which extends beyond the close of Plaintiff's taxable year. Plaintiff contends that the method of accounting which the Commissioner seeks to force upon it does not clearly reflect its net income in any sense of the word.

Plaintiff claims that under Section 41 of the 1939 Code and Section 446 of the 1954 Code it is required to file its tax returns in accordance with the method of accounting regularly employed in keeping its books and records unless such method does not clearly reflect its income.

Plaintiff also contends that under Section 42 of the 1939 Code and under Section 451 of the 1954 Code, it is not required to report advance dues as income in the year of receipt, if under the method of accounting used in computing its taxable income, such dues are to be properly accounted for as of a different period.

Plaintiff claims that the United States Supreme Court decision in *Automobile Club of Michigan* versus *Commissioner*, reported at 353 U.S. 180, is not controlling, in so far as this proceeding is concerned, for a number of reasons.

First, the Supreme Court decision was a factual decision based exclusively upon the evidence before the Court in that case. It is evident that the decision was grounded only upon the facts, or lack of facts, in that case from the fol- [fol. 5] lowing quotation from the majority opinion of the Court, and it was a five to three decision on this issue, the majority opinion being written by Mr. Justice Brennan.

Quoting from Mr. Justice Brennan's opinion, he stated:—

Commissioner Bennett: What page?

Mr. Bomar: I have the Lawyer's Edition, Your Honor, and it is page 753. It is the final part of the Court's decision on the third issue involved in that case.

Mr. Kane: Your Honor, it is page 9 of the slip opinion.

Commissioner Bennett: I have the United States Reports, so we are all using three different volumes. I will find it.

Mr. Bomar: (Quoting)

"The pro rata allocation of the membership dues in monthly amounts is purely artificial and bears no rela-

> tion to the services which petitioner may in fact be called upon to render for the member."

And at that point a footnote appears in which the Court stated that:

> "Beacon Publishing Company, 218 F. (2d) 697, and Schussler v. Commissioner, 230 F. (2d) 722, were distinguishable on the facts because in Beacon, performance of the subscription in most instances was in part necessarily deferred until the publication date after [fol. 6] the tax year. In Schussler, performance of the service agreement required the taxpayer to furnish services at specified times in years subsequent to the tax year."

Then Mr. Justice Brennan continues:

> "Section 41 vests the Commissioner with the discretion to determine whether the petitioner's method of accounting clearly reflects income. We cannot say, in the circumstances here, that the discretionary action of the Commissioner, sustained by both the Tax Court and the Court of Appeals, exceeded permissible limits."

Now, the following quotation from the dissenting opinion of Mr. Justice Harlan, concurred in by two members of the Court, also makes it abundantly clear that the Court did not apply the "claim of right" doctrine. In the last paragraph of his opinion, he states:

> "The Court, however, now by-passes the Commissioner's 'claim of right' argument and rests its decision instead on the ground that the 'pro rata allocation of the membership dues in monthly amounts is purely artificial and bears no relation to the services which petitioner may, in fact, be called upon to render for the member,' so that it cannot say that in doing what he [fol. 7] did the Commissioner exceeded the limits of his discretion. I do not understand this. . . ."

The Michigan case is also clearly distinguishable because Plaintiff in this case intends to establish the fact that there

is a direct relationship between the period of time over which prepaid dues are recognized as gross income and the cost of serving the members over such period of time. Proof of this fact, it is submitted, should establish that Plaintiff's method of accounting is not artificial.

Plaintiff also intends to establish that the method of accounting forced upon it by the Commissioner of Internal Revenue does not and cannot reflect its net income accurately and that the accounting profession is in complete agreement on this point. Plaintiff contends that if the Commissioner requires Plaintiff to pay income taxes in accordance with a method of accounting which does not reflect its true net income, the Commissioner has exceeded permissible limits of his discretionary authority.

The final ground of distinction is that the Michigan case involved the taxable years 1943 through 1947 which were governed exclusively by the provisions of the Internal Revenue Code of 1939. By contrast, the computation of the 1954 calendar year loss incurred by Plaintiff which gives rise to the operating loss carryback deductions claimed by [fol. 8] Plaintiff for 1952 and 1953 is governed by the provisions of the 1954 Code. The 1954 Code broadened the provisions relating to permissible accounting methods and the Senate Finance Committee Report explained Section 446 of the 1954 Code, stating as follows:

> "A method of accounting which reflects the consistent application of generally accepted accounting principles in a trade or business will ordinarily be considered as clearly reflecting income."

Plaintiff expects to establish the fact that its method of accounting is in accord with generally accepted accounting principles for motor clubs for the reason that under generally accepted accounting principles, advance dues cannot be recognized as gross income until services are rendered or made available to the member.

Finally, Plaintiff contends that if the evidence should reveal that there have been any changes during the years in issue in the procedures or mechanics involved in the computation of its Unearned Dues Liability account as of December 31st each year, and if any such change is contested by Government counsel, any such change, if material,

would merely constitute a Rule 38 (c) adjustment, and would have no bearing whatsoever on the single issue presented to the Court in this case, which is whether Plaintiff's [fol. 9] consistent method of deferring prepaid and advance dues is proper in order to clearly reflect its net income.

Commissioner Bennett: Mr. Kane?

Mr. Kane: Commissioner Bennett, I think he has stated the issues very well and, as he points out, our defense is based on the Supreme Court Decision in Automobile Club of Michigan, 353 U.S., 180. I believe all the questions that are in issue here today were considered by the various courts in that proceeding and I think it is really a legal issue as to whether or not they were, and that would be our basic position. I am not making any legal arguments here this morning.

Commissioner Bennett: You may call your first witness, Mr. Bomar.

Mr. Bomar: Mr. Blum, please.

Whereupon—FREDERICK M. BLUM, a witness produced on behalf of the Plaintiff, being first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Bomar:

Q. Please state your name, address and occupation.

A. My name is Frederick M. Blum. I reside at 4412 [fol. 10] Springdale Street, N.W., City of Washington, D. C. I am auditor of the American Automobile Association.

Q. How long have you served as auditor of the American Automobile Association?

A. Since 1931.

Q. Please describe your duties as auditor.

A. I am in charge of the Accounting Department of the Association. My work in that capacity is primarily responsible to management for accounting and record preparation of financial statements and interpretations thereof and related accounting functions such as procedures, methods, budgets, tax matters, et cetera.

Q. Are you a Certified Public Accountant?

A. I am.

Q. In which state or jurisdiction did you receive your certificate?

A. I received my certificate in 1929 from the District of Columbia, and also from the State of North Carolina.

Q. Mr. Blum, have you read and are you familiar with the facts alleged by the American Automobile Association in its petition in this case, as well as the Government's answer and agreed stipulation of facts?

A. I have and I am.

Q. Let me direct your attention to Paragraph 7 of Plain-
[fol. 11] tiff's petition, which describes in very general language the method of accounting followed by the American Automobile Association with respect to the recognition of advance dues as income. How long has this method of accounting been employed by the American Automobile Association?

A. It has been employed ever since I was employed as auditor, for the past 27 years.

Q. And, Mr. Blum, since you have been auditor of the American Automobile Association has the Association ever followed a method of accounting which recognized the advance dues received from members of its divisions as income entirely within the year of receipt?

A. No, it has not.

Q. Why not?

A. Because that does not, in my opinion, properly—

Mr. Kane: I object to the question and answer as a conclusion.

Commissioner Bennett: Are you offering him as an expert on this, Mr. Bomar?

Mr. Bomar: He is a Certified Public Accountant, Your Honor, with many years of experience. We are dealing with the subject of a method of accounting which seems to me peculiarly within the competence of an accountant.

Commissioner Bennett: Does defense counsel wish to
[fol. 12] examine him on his qualifications?

Mr. Kane: I will agree that he is a certified public accountant, but I don't believe he has been qualified as an expert by the petitioner here.

Mr. Bomar: Without qualifying him as an expert I was merely asking for a factual reason as to why the books and records are kept in accordance with this method of accounting.

Mr. Kane: If he wishes to answer, why, I won't object. I object to the conclusion on the part of this witness without the proper background.

Commissioner Bennett: You may restate your question to satisfy counsel.

By Mr. Bomar:

Q. Why, Mr. Blum, in keeping the books and records of the Association, did you not use a method of accounting which recognized the advance dues as income in the year of receipt?

A. Because that is not in accordance with good accounting principles.

Q. In what year was the American Automobile Association first required to file—

Mr. Kane: Would you have him explain that answer so we will have it all at this point?

Mr. Bomar: I think that is proper, sir, in cross-examina-
[fol. 13] tion.

Mr. Kane: Fine. Thank you.

By Mr. Bomar:

Q. In what year was the American Automobile Association first required to file a Federal income tax return and to pay a Federal income tax?

A. 1943.

Q. Was the method of accounting described in Paragraph 7 of Plaintiff's petition in this case used in keeping its books and records and filing its Federal income tax returns in 1943?

A. Yes.

Q. Was the method of accounting which you have described used both before and after the Plaintiff was taxable?

A. Oh, yes, it has been used since 1931.

Q. When did the Internal Revenue Service first rais-

any question in an official communication to the American Automobile Association with respect to its method of accounting?

A. That was in April of 1954 upon receipt of a thirty-day letter assessing deficiencies for the years 1950, 1951 and 1952.

Q. Was the Association required to pay those deficiencies?

[fol. 14] A. No, they were not.

Q. When was the Association first required to pay Federal income taxes on the basis that advance dues should or must be recognized as gross income entirely in the year of receipt?

A. 1953 and for the years subsequent.

Q. Who were the independent certified public accountants for the American Automobile Association during the years in litigation?

A. Ernst & Ernst.

Q. How long had that firm served as your independent Certified Public Accountants?

A. Since the year 1931.

Q. Mr. Blum, will you please illustrate to the Court as simply as possible the method of accounting used by the Club with respect to the recognition of advance dues as gross income? For example, let's assume that the member pays dues of $12 in advance for services to be rendered over the ensuing twelve-month period, how does the American Automobile Association account for the $12 of advance dues?

A. Well, that would depend upon the method in which those dues were received. If we received those advance dues or prepaid dues in the month of January then we would pay one-twenty-fourth of the amount as earned income during [fol. 15] January, one-twelfth each ensuing month, then when he reached December 31st the remaining 1/24th would constitute a liability as of the end of the year. If on the other hand those dues were received in December, only 1/24th or 50 cents would be taken up as earned revenue and the other 23/24ths, or $11.50, would be a liability as of the end of the year.

Q. Mr. Blum, I would like to direct your attention to

Paragraph 8 of the agreed stipulation of facts which sets forth the amount of dues on a monthly basis, which the records of the Automobile Association show as having been received during the calendar year 1953. I also call your attention to Paragraph 10 of the agreed stipulation which states that out of $3,531,178.67 of dues recorded on the books as having been received in 1953, the sum of $1,755,407.46 was not recognized as gross income during the calendar year 1953 but remained in a liability account at the end of the year. How was this sum of $1,755,407.46 computed?

A. It was computed by the method I have just mentioned, namely, of going back to the January figure, 1/24th of that constituted a liability at December 31st, 3/24ths of the February figure, and so on, and a computation of that will arrive at $1,755,407.46.

Q. Mr. Blum, have you computed at my request the [fol. 16] percentage of the total advance dues recorded on the Plaintiff's books in the calendar year 1953 which were recognized as gross income in 1953 as contrasted with the percentage which remained in a liability account as of the end of the year?

A. I have.

Q. And what are those percentages?

A. The proportion of the advance dues received taken into earned revenue was 50.3 per cent and the amount of liability was 49.7 per cent.

Q. Now, Mr. Blum, I call your attention to Paragraph 13 of the agreed stipulation of facts which shows on a monthly basis the advance dues received from members of the divisions during the calendar year 1954. What percentage of those advance dues was recognized as gross income in 1954 and what percentage remained in the liability account for deferred or unearned dues as of December 31, 1954?

A. 50 per cent is reflected as earned revenue and 50 per cent as earned revenue at the end of the year.

Q. Under the method of accounting employed by the American Automobile Association, have all expenses paid or incurred during a particular taxable year been deducted in the taxable year paid or incurred?

A. No, they have not.

[fol. 17] Q. Which expenses were not deducted in the year paid or incurred?

A. The prepaid membership costs were pro rated on the same basis as the advance or prepaid dues.

Q. And why were they not deducted even though they were paid or incurred?

A. Because the expenditures were made at the time of the receipt of the dues and covered the same period of time for which the membership was applicable, and, therefore, the expenses were spread over the same period.

Q. What items does your accounting department consider to fall in the classification of prepaid membership costs?

A. The commissions paid to the membership representatives at the time they obtain the membership and the payments which are made for personal accident insurance policies covering the period of a year for the same period of the membership.

Q. Mr. Blum, you have stated that you are the manager of the American Automobile Association Accounting Department with the title Auditor. Approximately how many persons were employed in this department during the calendar years 1953 and 1954?

A. There were approximately 70 persons.

Q. With a staff this large operating the various ac- [fol. 18] counting functions, do you directly handle the preparation of financial data, technical operating problems, et cetera?

A. No, I do not. I am responsible to management for the proper operation of the department, but the technical matters and the detailed operations have been delegated to my assistant, Mr. Arthur I. Cooper, who also is a Certified Public Accountant.

Mr. Bomar: Thank you, Mr. Blum. Your witness.

Cross examination.

By Mr. Kane:

Q. Mr. Blum, you in your direct examination stated that the first year in which there was a dispute as to the method

of accounting used was prior to 1953. I believe 1952 was involved in that dispute, as I recall it 1949 through 1952.

A. I think it was 1950, 1951 and 1952. You may be correct.

Q. Roughly it was those years. And you said that the method was acceptable at that time. Was it accepted as a result of a compromise settlement between yourself and the staff whereby you gave up your claim for exemption and they in turn allowed you this method of accounting, or do you know?

A. Well, I know it was a result of a compromise settle- [fol. 19] ment. As to giving up any right of claim or anything for exemption, I wouldn't want to answer that. I think that's something someone else would probably know better than I.

Q. You did not participate in these conferences?

A. No, only on the staff level.

Q. The staff level is where this particular matter—

A. I mean our staff, not the Internal Revenue Service.

Q. You are familiar that during the time this settlement was made that there were two sections of the Code then in effect, 452 and 462 of the Revenue Code of 1954 which were subsequently eliminated by Congress?

A. Yes.

Q. And that these sections specifically provided for relief in prepaid income cases?

A. That's my understanding.

Q. That is my understanding, too. I don't have the books here.

A. I have to answer that on the general basis. I don't know that I am qualified to answer that.

Q. I just said generally because we are both quoting from Section 452 and will quote from 452 in our briefs and requested findings.

You also gave testimony that, as alleged in Paragraph 7 [fol. 20] of the petition, you followed the consistent method of accounting throughout the years from 1931 right through at least the years in suit and to date, as far as I understand it. Isn't it true that there was a change in 1954 in your method, at least a change in your procedure or method as to how you pro rated the membership income in 1954 as opposed to 1953?

A. Yes, sir, there was.

Q. Will you explain that for the record, Mr. Blum?

A. During the year 1954 we were having our procedures reviewed and surveyed and a recommendation came to my desk that without changing the basic principle of properly reflecting income and the proper liability at the end of the year, that we were going to an awful lot of detailed work internally in computing a lot of figures and that we could arrive at the same result by pro rating our dues each month on the basis of taking up of the prepaid dues for that month 50 per cent into earned revenue and 50 per cent to be set aside as a liability.

We made various tests and I am sure our outside auditors did also, because we were in session with them on this point and we found differences.

I think I gave, in direct examination, for 1953 on this rather lengthy process that we followed, the earned revenue was 50.3, the liability was 49.7, and here we come up with a [fol. 21] 50-50 basis. It saved a great deal of internal work and we accepted that on recommendation, in changing of our principle of properly stating our earned dues and the proper liability.

Q. Didn't it go farther than that, Mr. Blum, that before 1954 you actually took into account on an accrual basis the income which was due rather than actually received?

In other words, to simplify it, if I signed a contract with you for $15 but did not pay the entire $15, you still put on your books $15 as of the receipt of my contract?

A. Yes, we did that prior to 1954.

Q. And then in 1954, instead of following that method or procedure, you only put on your books the $5 payment or the $10 payment as I actually sent them into your office?

A. That is correct.

Q. Now, the second change in method or procedure which occurred in 1954 involved, as I recall it, the question of treatment of commissions to salesmen and the overwrite to the manager, the overwrite being his commission to a certain extent; is that correct?

A. That, of course, has nothing to do with prepaid dues or advance dues. That is an expense factor and we did make a change during the year 1954 with respect to those expenses.

[fol. 22] Q. And would you explain that change for the record?

A. Yes. It was brought to my attention again, resulting from this survey and my own staff as well as our outside public accountants, that we had an inconsistency on our records in that some persons were paid a straight salary, which, of course, was the expense of that year, and other persons in identical capacity received a very small stated salary, and the rest of their compensation came from what we call overwrite, namely, certain amount per membership produced. In other words, we might have one manager of a division—and I am merely using figures here—getting $12,000 a year as a straight salary, we have another manager getting $3,000 a year as a straight salary and getting another $6,000, $7,000 or $8,000 as an incentive based on membership, both items being compensation in the final analysis. We had previously pro rated those overwrites. We realized that that was not good accounting and we made the change.

Q. You had pro rated the overwrite but not the salary?

A. That's right.

Q. Was that also true as far as the salesmen were concerned, if you can recall?

A. I know what you are referring to now. Yes, we would employ new salesmen, and for a short period of time, be-
[fol. 23] cause I think it is pretty well generally realized that in any general sales field it is difficult to employ people just on a straight incentive basis. We would say to a new employee we would guarantee that employee, let's say, $300 a month for, say, six months as the case might be. We considered that on our records at one time the same as being commissions. We realized that that was not an accurate statement, and in 1954 we computed the earnings based upon members produced times what that individual was supposed to get per member, and then if there was a difference we considered it to be a salary, under a guaranteed salary, training expense set-up.

Q. Then you deducted that in full for 1954?

A. The remaining, that's right.

Q. Did you defer any expenses after 1954?

A. I don't understand your question.

Q. Any salesmen expenses or commission expenses?

A. The commissions?

Q. After 1954, too.

A. Oh, yes.

Q. But not the overwrite?

A. Not the overwrite nor guaranteed salaries.

Q. Nor guaranteed salaries. You mentioned a personal accident insurance policy.

A. Yes, sir.

[fol. 24] Q. These personal accident insurance policies are mentioned in the first paragraph of our stipulation. Now, each member gets that personal accident coverage with his membership for a year?

A. That's right, for a period of his membership.

Q. For the period of his membership. And that is the other item that you had previously deferred as a membership cost?

A. That's right.

Q. How do you handle that personal accident insurance, do you actually have an insurance company of your own?

A. No. That is under contract with an insurance company which issues a master policy to the organization under which individual certificates may be issued to the members. I think the use of the words "personal accident insurance policy" for the individual is a misnomer. It is a certificate under a master policy and I think it is a general practice in other group fields where a master policy is issued and then individual certificates can be issued under the master policy.

Q. You get a group policy rate?

A. That's right.

Q. At the end of a year would you normally have something coming back from the premiums, or would you know?

A. That is possible, yes, under the contract. If the loss [fol. 25] ratios are quite satisfactory there can be a repayment at the end of the year.

Q. And that goes where, to the individual member or to the organization?

A. Oh, no, that goes back to the organization.

Q. Into its general fund?

A. That's right, taken up as revenue at that time.

Q. Now, I would like to ask you a few questions about how this money is handled, or would you prefer that I ask that of Mr. Cooper? It is immaterial.

A. He knows the detail probably better than I do, but it is up to you.

Mr. Kane: I will have no further questions of Mr. Blum at this time, but could we keep Mr. Blum around?

Mr. Bomar: Yes.

Mr. Kane: Thank you.

Redirect examination.

By Mr. Bomar:

Q. Mr. Blum, you stated that the American Automobile Association was engaged in prior litigation; is that correct?

A. On this subject?

Q. Not on this subject.

A. Not on this subject, no.

Q. What years were involved in the prior litigation?

[fol. 26] A. Are you speaking of the original litigation or the exemption question?

Q. Exactly.

A. The years of 1943, 1944 and 1945 and the carrybacks for 1946 and 1947.

Q. What method of accounting was used by the American Automobile Association during those years in litigation?

A. The same method which I heretofore described.

Q. Was any issue raised in that litigation with respect to the accuracy or the propriety of your method of accounting?

A. None at all.

Q. Mr. Blum, you have stated that in the year 1954 there were certain changes made in the mechanics of computing that proportion of dues received during a year which were recognized as income or revenue and in that proportion which were still considered to be a liability as of the end of the year. Have you, at my request, prepared a schedule from your financial statements and tax returns showing the proportion of dues received during the five years prior to the years in litigation or during the years 1949 through

1953 which shows total dues recorded on the books as having been received and the proportion of the total dues which were not recognized as gross income during the year?

[fol. 27] A. That is correct, sir.

Q. Is this the schedule?

A. Yes, that is it.

Mr. Bomar: I offer to present it in evidence as Plaintiff's Exhibit No. 8.

Commissioner Bennett: I have marked the others as joint exhibits since they were stipulated. Shall we make this one Plaintiff's Exhibit No. 1?

Mr. Bomar: Yes.

Commissioner Bennett: Has the Government counsel seen a copy of this?

Mr. Kane: I have seen it, Your Honor.

Commissioner Bennett: Is there any objection?

Mr. Kane: I have no objection, Your Honor. I would like to ask him a question about it, however.

Commissioner Bennett: If there is no objection it will be received as Plaintiff's Exhibit No. 1 in evidence.

(One-page document showing prepaid dues received, deferred revenue membership dues, and percentage, for the years 1949 through 1953 was marked Plaintiff's Exhibit No. 1 and received in evidence.)

By Mr. Bomar:

Q. Mr. Blum, during the calendar year 1949 what percentage of prepaid dues was recognized as revenue or income and what percentage of prepaid dues was considered [fol. 28] to constitute a liability as of the end of the year?

A. The liability at the end of the year was 50.1 per cent, and the revenue, then, would be 49.9 per cent.

Q. And in 1950?

A. The percentage was exactly 50 per cent.

Q. And in 1951?

A. The liability at the end of the year would be 49.8 per cent. The revenue taken up during the year, therefore, would be 50.2 per cent.

Q. And in 1952?

A. The liability is 49.4 per cent, and the earned revenue taken up, therefore, would be 50.6 per cent.

Q. Mr. Blum, in your opinion was any change in accounting practices connected with accounts receivable during the calendar year 1954?

A. I don't know that I understand your question, sir.

Q. On cross-examination you explained to Mr. Kane that during the calendar year 1954 a change in procedures was involved in so far as new members are concerned and that instead of regarding money as having been received on your books, when a new member signed an application to become a member of your organization he waited until the cash came in from the member. Can you explain from an accounting point of view why that change was made? [fol. 29] A. I think I can. It was brought to my attention that when we set up this portion of receivables on our record, and I guess it was understood or known that these are not the only receivables which we carry on the books, because at the end of 1953 and 1954 we had something like a half million dollars receivables on the books, but with respect to this relatively small amount and very small individual items, it was brought to my attention first, if I can remember the various points, but one would be that at the time we set up this receivable we were in effect at the same time setting up a liability, because we did not consider that dues were properly earned when received. Therefore, in effect, when we set this receivable up we were also in effect setting up a liability, so there we have a counterbalance item.

Secondly, we did not actually follow through with any legal rights on these items by forcing collection. If an individual didn't pay at the end of 65 days we just cancelled and offset the figure on our books, and, taking into consideration the very small amount involved, I believe at the end of 1954 the amount was about $44,000, and against which we would have an obligation to our salesmen of about $9,000, and considering all of those factors and the multiplicity of $5 and $10 items involved, it did not change our method of accounting, just to eliminate those and not con- [fol. 30] sider them as assets as such but carry them as memoranda accounts, which we did.

Q. Mr. Blum, in connection with the $44,000 receivable items which you mentioned, I am not sure that I understand the nature of the offset. Would the entire $44,000 be recognized as income or revenue, or would a portion of it be considered not to be revenue until services were rendered?

A. I thought that was explained. When we set up a receivable it was offset by a liability, so we took off proportionately on the receivables, and, therefore, we are talking about a very minor figure.

Q. For the calendar year 1954 did the American Automobile Association continue to defer as a deduction or spread as a deduction over the entire period of a membership those items which your Accounting Department considered to be truly prepaid membership costs?

A. Yes, we did continue that.

Q. And what items were continued to be spread? What items which you had paid did you not claim a deduction for except on a pro rata basis?

A. The Commissions paid to salesmen and the amounts paid the insurance company for personal accident insurance certificates.

Mr. Bomar: That is all.

[fol. 31] Recross examination.

By Mr. Kane:

Q. Then, I take it from your last answer that the other expenses connected with memberships were deducted as they accrued or were paid under your method of accounting?

A. All other expenses of the organization?

Q. Of the organization. For members, to service the members, any type of that kind were either approved or paid in the year billed?

A. As incurred, yes.

Q. This Plaintiff's Exhibit No. 1 which you prepared, just to make the record clear for me, you included in the prepaid dues received on a basis, as I recall it, of 1/24th of the first month, 1/12th for the next 11 months, and 1/24th again in the 13th month?

A. That is correct.

Q. You took up 1/24th of the accounts receivables whether it was actually paid with the membership or was to be paid in installments; is that correct?

A. In those years the amounts of accounts receivables would be included. Let's say for the year 1953 I think we had some $30,000 as a part of this $3,531,000, this accounts receivable figure.

Q. At the end of the year?

A. That's right.

[fol. 32] Q. But starting with January and going to December, as time went on, what you started out with as an accounts receivable in January would normally be paid in March?

A. That's right.

Q. Within 60 days?

A. That's right. And, therefore, the only amount involved in this would be the $30,000 paid at the end of the year.

Q. That is what I wanted to make clear for the record.

Now, the second question, I think you or Mr. Bomar said new members in this 1954 change, whatever the procedure or method was, as I recall it, it was not only a change for new members but for the members whether they were new or renewing their past memberships, it was still the same, you started picking up as they paid them rather than as you billed them?

A. Are you talking about receivables, sir?

Q. No, the 1954 method. I am sorry. The receivables in 1954, when Mr. Bomar, I believe, said you adopted a change in procedure or method for new members whereby you only took up what they actually paid. I want to ask only one question. Didn't this also apply to renewal of old members?

A. Only, you might say, now and then very, very few, [fol. 33] because on the renewals it has been the policy of the organization, and still is, to send out the renewal information, billing, in some cases the credentials, and no record is made on the books nor ever has been made on the books until payment was received. There might be some few exceptions to that, but they would be few and far between. Basically your billing is for new members and not renewals.

Q. For renewals you always waited until you received the money?

A. That's right.

Mr. Kane: Thank you. I don't think I have any more questions of Mr. Blum. Thank you very much.

Commissioner Bennett: You may step down. Thank you.

(Witness excused.)

Mr. Bomar: Mr. Cooper, please.

Whereupon—ARTHUR I. COOPER, a witness produced on behalf of the Plaintiff, being first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Bomar:

Q. Please state your name, address and occupation for the record.

A. My name is Arthur I. Cooper. My residence is 7229 [fol. 34] Garland Avenue, Takoma Park. I am assistant auditor of the American Automobile Association.

Q. How long have you been employed by the American Automobile Association?

A. I was employed on April 6, 1953 as assistant to the auditor and I was made assistant auditor on April 29, 1954.

Q. Please describe briefly your educational background and experience.

A. I received a Bachelor of Arts Degree from Johns Hopkins University in 1943. I am a Certified Public Accountant of the State of Maryland, having received my certificate in 1951. Prior to joining the American Automobile Association I spent five years in public accounting practice in Hagerstown, Maryland.

Q. Please describe briefly your duties as assistant auditor of the American Automobile Association.

A. As immediate assistant of the auditor I am responsible for the day to day operations of the Accounting Department, including the maintenance of the general

ledgers and books and records of the American Automobile Association and its ten divisions.

Q. Mr. Cooper, have you read the petition filed by the American Automobile Association in this case, as well as the Government's answer and the stipulation of facts?

[fol. 35] A. Yes, sir, I have.

Q. Mr. Cooper, describe briefly what accounting records are under your supervision and are maintained in so far as the divisions of the American Automobile Association are concerned.

A. We keep separate ledger accounts for each of the ten divisions, which show the income and expense by division. From these general ledger records our monthly financial records are prepared.

Q. Who has the responsibility for maintaining the accounting records for the divisions?

A. The accounts and records are actually kept by personnel of the Accounting Department under my direct supervision.

Q. Have you prepared at my request a schedule which shows the total expense by months paid or incurred by all divisions of the American Automobile Association for the five-year period prior to 1953?

A. I have.

Q. And from what source was this schedule prepared?

A. The schedule was prepared from our regular monthly financial statements which are produced for the information of headquarters management and the managers of our division.

Q. And are those records available in the courtroom?

A. Yes, sir, they are.

[fol. 36] Q. Are these the schedules?

A. Those are the schedules.

Q. And would you explain briefly what appears in the next-to-the-last column of this schedule?

A. The next-to-the-last column represents the total expenses over a five-year period by month, that were incurred by our division operations. It includes all of the expenses of all ten divisions.

Q. Are these the costs involved in serving all of the members on a monthly basis during the five-year period?

A. Yes, sir, they are.

Q. And would you kindly explain the last column in the schedule?

A. The last column shows the percentage, the average percentage over a five-year period that the expenses were incurred by months. For example, for January, over a five-year period, we actually incurred expenses amounting to $824,652.89. For the entire five-year period the expenses were $11,021,870.54. The percentages shown in the last column were derived by dividing the expenses by months by the total for the five-year period, thus indicating the proportion of expenses on the average over a five-year period that were incurred by months.

Q. Mr. Cooper, was this schedule prepared by records maintained in the ordinary course of your business?

[fol. 37] A. Yes, sir, they were prepared from our regular general ledger records and financial statements that are prepared on a regular monthly basis for the information of management.

Mr. Bomar: Your Honor, I offer this schedule in evidence as Plaintiff's Exhibit No. 2.

Mr. Kane: No objection.

Commissioner Bennett: Received.

(One-page sheet showing monthly costs and expenses, five years 1948-1952, divisions only, was marked Plaintiff's Exhibit No. 2 and received in evidence.)

By Mr. Bomar:

Q. Mr. Cooper, have you, at my request, prepared a schedule which refers to the prepaid or advance dues shown as having been received by the American Automobile Association from its divisions in the calendar year 1953, in accordance with the agreed stipulation, and which schedule also recognizes as gross income or revenue a proportionate part of advance dues in proportion to the five-year historical costs?

A. Yes, I have.

Q. And is this the schedule?

A. This is the schedule that I prepared.

Q. And was the information obtained in this schedule prepared by you or under your supervision?

[fol. 38] A. It was.

Q. Now, Mr. Cooper; if instead of a pro rata allocation of dues or if instead of recognizing advance dues as income on a time basis as services are rendered or made available, advance dues had been recognized as income in proportion to the average cost of serving a member during the preceding five years, what proportion of the 1953 dues recorded on your books as having been received in 1953 would have been reflected in income in 1953 or would have been recognized as revenue, and what proportion would remain in the liability account as of December 31, 1953?

A. As shown in the exhibit, the next-to-the-last column shows a total of $1,778,627.57, which would have been included in our income account for the year 1953 out of a total of $3,531,178.67.

If I may just explain the schedule, the first column shows the amount of dues received by month during the year 1953, and totals $3,531,178.67.

Across the top of the schedule we have shown the monthly percentages that were determined in Plaintiff's Exhibit No. 2 as applicable over the five-year period and shown the percentage of costs determined by months during the preceding five-year period. We have then applied these percentages to the monthly dues and have shown as income by month the appropriate proportion of the monthly dues [fol. 39] received. For example, in January of 1953 we received dues in the amount of $257,698.02.

Because these dues are received during the entire month on different days we have assumed that approximately one-half the dues would be received in the month of January. Therefore, we show as income one-half of the amount of dues received, multiplied by 7.48 per cent, resulting in income in January of $9,637.90. Then we have applied the percentages indicated to that same January dues figure of $257,698.02, resulting in the income allocated to each of the months.

The total for the year 1953 that would be recorded in income out of the January receipts on this basis would be $248,060.11, and the amount that would be recorded as a

liability for unearned dues as of December 31, 1953, would be $9,637.91.

Q. Mr. Cooper, I call your attention to Paragraph 10 of the agreed stipulation of facts, which states that in accordance with the method of accounting actually used by the Association, the sum of $1,755,407.46 out of all dues recorded as having been received in 1953, remained in the liability account as of the end of 1953. How does the method which you used compare with the method of accounting which would have recognized the advance dues as income as expenses when incurred on an historical basis?

A. By reference to the last column to the right on Ex- [fol. 40] hibit No. 3, you will see that the liability given as of December 31, 1953 shows $1,752,551.10, which is our liability computed on the basis of the preceding five-year cost experiences. This compares with the $1,755,000 figure which you read from the stipulation.

Mr. Bomar: Your Honor, I offer that schedule in evidence as Plaintiff's Exhibit No. 3.

Mr. Kane: I object to that schedule being received in evidence on the basis that it is Government's position that it is irrelevant and immaterial to this case. We do not agree in essence that the Supreme Court was not aware that there was a deferment of membership dues and they had exactly the same facts presented to them. They decided this case adversely to the Plaintiff.

This statement quoted in the Supreme Court decision on which the Plaintiff appears to be relying here today, we don't believe is a basic reason for the Supreme Court's decision that if there had been a relationship between the cost of services pro rated and that type of evidence had been put into the record, that the Supreme Court's decision would have been any different. We believe that the minority opinions in this Supreme Court decision show clearly that the Court considered the fact that the income was taken into account this year and that there would be expenses connected with those new memberships during the [fol. 41] following year, and we believe that a showing of this type is irrelevant to the proper decision of the legal issue in this case.

Mr. Bomar: Your Honor, the decision in the Supreme Court case of Automobile Club of Michigan was grounded upon the fact that there was no proof of the fact that the pro rata allocation of dues on a monthly basis had any relationship to the services which the Plaintiff called upon the Club to render, and that that ordinarily relates it to the cost of service that Plaintiff was called upon to render.

We have examined the record in the Michigan Auto Club case and would be delighted to have it introduced as a part of the record in this case if it becomes material as to what evidence was produced in that case, or the lack of evidence, but certainly we contend in our case we have a right to approve what the facts are and to accrue the deficiency which the attorneys for the Plaintiff in that case apparently failed to substitute the missing facts which were not shown in the Michigan case.

Commissioner Bennett: Objection overruled. Plaintiff's Exhibit No. 3 is received.

Mr. Kane: May I have an exception, Your Honor?

Commissioner Bennett: Yes. I should have stated that both of you may have an automatic exception to any ruling I make, so you won't have to state it on the record.

[fol. 42] (Document entitled "Deferred Revenue—Membership Dues at December 31, 1953 Based on Cost Percentages for Five Years 1948 to 1952," was marked Plaintiff's Exhibit No. 3 and received in evidence.)

By Mr. Bomar:

Q. Mr. Cooper, the two schedules which have been introduced as Plaintiff's Exhibits Nos. 2 and 3 relate entirely to the calendar year 1953. Have you, at my request, prepared a schedule which shows the total cost incurred by months for all divisions of the American Automobile Association for the five-year period preceding the calendar year 1954?

A. I have.

Q. And is this the schedule?

A. Yes, sir, this is the schedule.

Q. And would you explain this schedule?

A. This schedule was constructed on exactly the same

basis that the preceding schedule labeled Plaintiff's Exhibit No. 2 was.

Q. Was it constructed from information obtained from the same accounting sources?

A. The information was obtained from the same sources, yes, the monthly costs represent the total costs of our divisions for the months and years in consideration, namely, the years 1949 through 1953.

[fol. 43] Q. What is the difference between this schedule and Plaintiff's Exhibit No. 2?

A. The difference solely is that it covers the years 1949 through 1953, whereas Exhibit No. 2 covered the years 1948 through 1952.

Q. And have you, at my request prepared an exhibit comparable to Plaintiff's Exhibit No. 3 except that it pertains to the calendar year 1954?

A. I have.

Q. And is this the schedule?

A. This is the schedule.

Q. And will you explain the schedule?

A. The schedule was prepared in the same fashion that Plaintiff's Exhibit No. 3 was prepared. It shows in the left-hand column the amount of prepaid dues received by month for the year 1954 and which is also, I believe, shown in the stipulation of facts in this case.

Across the top of each column we show the percentages which were computed and are shown on Exhibit No. 4 and which represent the proportion of expense incurred by month over the preceding five-year period. These percentages, then, were applied in the same way as in Exhibit No. 3 to the monthly dues. For example, for January 1954 we received dues in the amount of $290,764.23. Again assuming that these dues were received evenly throughout [fol. 44] the month of January, we applied the percentage of 7.46 per cent to one-half the dues received in January, resulting in an allocation to January 1954 of $10,845.50. Then the percentage is shown for each month at the top of the page, 7.34 per cent for February, for example, 8.44 per cent for March and so on we applied to the $290,764.23, resulting in the figures shown in each column across the sheet.

These figures were then added, and in the next-to-the-last column to the right we show as income in 1954, $279,918.73 out of the total received for January 1954, of $290,764.23.

This leaves a liability at December 31, 1954 to cover the cost of rendering service to the members who will be on the records at the end of January 1954 and who were actually placed on the records on January 1953, in the amount of $10,845.50.

Q. Mr. Cooper, if during the calendar year 1954 the advance or prepaid dues recorded on the books and records of the Association as having been received in the calendar year 1954 were recognized as income or revenue in proportion to the historical cost of serving a member on a monthly basis, of the proportion of dues received in the calendar year 1954, would have been recognized as gross income of the Association and what proportion would remain in the liability account as of the end of 1954?

[fol. 45] A. Of the total dues received in 1954 of $4,078,529.17 we would have shown on a five-year average cost basis $2,070,078.69 as income in 1954 and shown a liability at December 31, 1954 of $2,008,450.48. These two latter figures are shown in the next-to-the-last and the last columns of Exhibit No. 5.

Q. Mr. Cooper, I direct your attention to Paragraph 14 of the agreed stipulation of facts, which shows that out of all dues recorded on Plaintiff's books as having been received during the calendar year 1954, the sum of $2,039,264.74 is not accounted for as income or revenue in the calendar year 1954. How does that figure compare with the sum which would have been recognized as income had income been recognized in proportion to total expenses incurred on a monthly basis?

A. If income had been recorded in proportion to expenses, as shown on Exhibit No. 5, we would have reflected an income in 1954 out of the total of $4,078,529.17, we would have shown as income $2,070,078.69, which is approximately $30,000 greater than the $2,039,264.74 mentioned in the stipulation.

Mr. Bomar: Your Honor, I would like now to offer in evidence as Plaintiff's Exhibits Nos. 4 and 5 the two schedules which Mr. Cooper has described.

Mr. Kane: Your Honor, may I have the same objection [fol. 46] and exception?

Commissioner Bennett: You may. Plaintiff's Exhibits Nos. 4 and 5 are received.

(One-page document entitled "Monthly Costs and Expenses Five Years 1949 to 1953 (Divisions Only)," was marked Plaintiff's Exhibit No. 4 and received in evidence.)

(Document headed "Deferred Revenue—Membership Dues at December 31, 1954, Based on Cost Percentages for Five Years 1949 to 1953," was marked Plaintiff's Exhibit No. 5 and received in evidence.)

By Mr. Bomar:

Q. Mr. Cooper, have you prepared, at my request, from books and records of the Association, maintained in the normal course of trade and business, a schedule which shows the total number of members of the American Automobile Association Divisions during the calendar year 1953?

A. I have.

Q. And does this schedule also show the total monthly cost of serving all members of the divisions in 1953?

A. It does.

Q. And have you computed the average cost of serving one member per month during the calendar year 1953?

A. We have computed such average costs.

Q. Is this the schedule?

A. This is the schedule we prepared.

[fol. 47] Q. Would you please explain this schedule to the Court?

A. Yes, sir. This schedule relates to the year 1953 and it shows in the left column by month the number of members on our records that were to be served in each of the months during 1953. Thus for January we had 220,435 members. In December we had 246,856 members.

The next column is the costs incurred by all of our divisions in serving these members. It is the same cost figures that are shown in some of the previous exhibits we have introduced.

By dividing the cost figures shown by month by the members to be served in each month we arrived at the average cost of serving a member in each month of the year 1953.

You will note that this figure is 1.12 for January and 1.10 for December. It varies slightly during the year.

In the next column we have related these monthly costs per member to the total cost per year, and we have divided the 1.12 average cost per member for January by the total average cost for the year 1953 into $14.50 and have resulted in a percentage of 7.71 per cent for January, 7.57 per cent for February, and so on.

Q. Now, Mr. Cooper, if we advance or prepaid dues re- [fol. 48] ceived by the American Automobile Association from members of its divisions in the calendar year 1953 had been recognized as income or revenue in proportion to the average cost of serving a member per month, what proportion of the advance dues received in 1953 would be recognized as income and what proportion would remain in the liability account as of the end of the calendar year 1953?

A. The next-to-the-last column of this exhibit shows the actual dues received of $3,531,178.67. Applying the various percentages determined by month to the monthly dues received, we have arrived at a liability as of December 31, 1953 based upon the average cost per month of serving members, of $1,774,100.96. Therefore, the amount of income that will be reported out of the total of prepaid membership dues of $3,531,178.67 would have been $1,757,977.71.

Q. Mr. Cooper, I call your attention to Paragraph 10 of the stipulation of facts, in which it is agreed that as of December 31, 1953 the portion of advance dues which were not recognized as income in 1953 and which remained in the liability account, equaled $1,755,407.46. How does this compare with the liability account as of December 31, 1953 had advance dues been recognized as revenue in proportion to the average cost of serving a member per month?

A. This is shown in the last column to the right on Exhibit No. 6, and the liability computed on the basis of the [fol. 49] average cost of serving members per month is $1,774,100.96, which is approximately $19,000 greater than

the liabilities shown. I am not sure about that amount. The figure you gave was $1,755,407.46, I believe.

Q. The figure shown in the stipulation as representing the liability for unearned or deferred dues as of December 31, 1953 is $1,755,407.46.

A. That compares with our figure computed on the average cost basis of $1,774,100.96.

Q. In other words, had prepaid or advance dues been recognized as income in proportion to the average cost of serving a member per month, that liability as of the end of December 1953 would have been greater?

A. It would have been greater by approximately $19,000.

Mr. Bomar: Your Honor, I offer this schedule in evidence as Plaintiff's Exhibit No. 6.

Mr. Kane: Your Honor, I take the same objection and exception as before.

Commissioner Bennett: Plaintiff's Exhibit No. 6 is received.

(One-page document entitled "Year 1953 Deferred Revenue—Membership Dues Based on Average Monthly Costs Per Member," was marked Plaintiff's Exhibit No. 6 and received in evidence.)

[fol. 50] By Mr. Bomar:

Q. Mr. Cooper, have you, at my request, prepared a schedule identical to the one you just described except it relates to the calendar year 1954 instead of 1953?

A. I have.

Q. And was this schedule prepared by you or under your supervision?

A. It was.

Q. And was it prepared from records of the Association available in this courtroom which were kept in the ordinary course of trade or business?

A. It was prepared from our regular monthly statements and ledger.

Q. Is this the schedule?

A. Yes, sir, this is the schedule.

Q. And would you explain briefly the contents of the schedule?

A. The schedule is similar to the previous schedule which was labeled Exhibit No. 6, except this schedule relates to the year 1954.

Q. All right.

A. Again, the first column shows the number of members on the records of our divisions which were to be served for each month for the year 1954. The second column shows the total costs incurred by all of our divisions in [fol. 51] serving all of its members. The third column represents the average cost of serving a member, which was derived by dividing the actual cost shown in column 2 by the number of members shown in column 1. Thus we arrive at a figure of $1.27 for February, which compares with a total of $14.72 for the entire year.

Then we have related these average costs per member to the total average cost per member per year and arrived at a percentage which shows, for example, that 7.62 percent of the total average cost for the year 1954 were incurred in January, 8.62 were incurred in February, and so on.

Applying these percentages and the monthly dues received in 1954 which are shown in the next-to-the-last column, and totals $4,078,529.17, to monthly dues received, we have arrived at our estimated liability as of December 31, 1954 based upon the average cost of serving a member. This is shown in the last column and totals $11,078 for January and $33,919 of the February receipts, and so on, with a total liability at December 31, 1954 of $2,088,784 out of a total received in 1954 of $4,078,529.17.

Q. Under the schedule which you have prepared what proportion of advance dues received in the calendar year 1954 would have been recognized as income in the calendar year 1954 if recognition was based on the average cost [fol. 52] per member per month basis?

A. On the average cost per member per month basis we had actually received dues in 1954 of $4,078,529.17, which is the amount shown in the stipulation of facts in this case. We would have computed a liability based on the average cost of serving members for each month of $2,088,784. This amount subtracted from the total $4,078,529.17 would have resulted in income for the year 1954 of $1,989,745.17.

Q. I call your attention, Mr. Cooper, to Paragraph 14 of the agreed stipulation of facts in which it is agreed that out of the total advance dues received in the calendar year 1954, the sum of $2,039,264.74 was recognized as gross income. How does that amount compare with the amount shown in your schedule?

A. The $2,039,264.74 shown in the stipulation is greater than the amount of dues we would have reported on this basis, namely, $1,989,745.

Mr. Bomar: Thank you, Mr. Cooper.

I would like to offer this schedule in evidence as Plaintiff's Exhibit No. 7.

Mr. Kane: I would like to have the same objection and same exception, Your Honor.

Commissioner Bennett: Same ruling. Plaintiff's Exhibit No. 7 is received.

[fol. 53] (One-page document entitled "Year 1954, Deferred Revenue—Membership Dues, Based on Average Monthly Costs Per Member," was marked Plaintiff's Exhibit No. 7 and received in evidence.)

Commissioner Bennett: You may inquire.

Cross examination.

By Mr. Kane:

Q. Do you have before you Plaintiff's Exhibit No. 2?

A. Yes, sir.

Q. This is entitled "American Automobile Association Monthly Costs and Expenses." Will you describe for me what you included in those costs and expenses?

A. The costs and expenses include all of the expenses of all ten divisions for the years in question.

Q. That would include salaries?

A. That would include salaries, includes rent, includes stationery and supplies, includes commissions, the emergency road charges and so on.

Q. These commissions that you have just mentioned, they are commissions paid to the salesmen?

A. Yes, sir.

Q. And when do the salesmen receive these commissions?

A. He receives his commissions at the time a payment is made on the dues.

Q. A payment, a $5 payment?

[fol. 54] A. In proportion to the payment. It varies in the different divisions but generally speaking the payment is made to the salesman at the time the money is received from the member.

Q. He does not receive the $2.50 immediately?

A. No, sir, unless it is all paid at once, of course.

Q. In your emergency road service you take as a deduction or set up as a cost in each month the amount that is accrued during that month or the amount that is paid?

A. Our costs are emergency road service costs during the year and represent the month it was paid or incurred during that year.

Q. Or incurred. On your publication costs, how would that be handled if you incurred a $30,000 expense for publication of maps or anything of that type? When would that be taken as a deduction?

A. The cost of our touring publications are recorded as an expense at the time the Division actually receives the various materials.

Q. From the printer?

A. From the printer.

Q. It is not pro rated?

A. No, sir.

Q. Are you familiar with the method in which the accounts are kept, the bank accounts?

[fol. 55] A. Yes, sir, I am.

Q. What type of bank accounts do you keep?

A. A number of various checking accounts at various locations in which the receipts of our Division offices are deposited and from which the various expenses are paid.

Q. When you say "receipts" that is both membership dues, the amounts paid for publications by anyone, or do you sell them that?

A. There is very little of that. I am not sure of the publications. Do you mean tour books, directories and maps and so on furnished to our members as part of their service?

Q. Yes.

A. Very little, if any, are sold because the rules of the Association say these should be restricted to the membership.

Q. What other receipts do you have except dues and the return of some of the premium which I understand might happen throughout the year?

A. In our division that is substantially all the income. There is some income from all areas in all divisions for this, but some divisions have a driver training school, and there would be some small income from that. There is also payment received from our insurance agency by some divisions covering a portion of their expenses.

[fol. 56] Q. You have travel commissions. What would they be?

A. The travel commissions almost entirely are the commissions earned by our foreign travel department and are not a substantial portion, or they are a very, very small portion of our division income.

Some of our offices are qualified as travel agents in order to sell airline tickets, for example, so there might be some small income resulting from the sale of airline tickets by some of the offices, or there might be some small income resulting from the sale of tours by some of the offices, but the amounts in question involved would be very small.

Q. You file, as I recall it, a consolidated return for your ten divisions and national headquarters?

A. It is a return for the entire Association, which is one corporation. I wouldn't call it a consolidated return.

Q. I am not an accountant, but I mean a group return for the ten divisions.

A. All of the expense and all income for all of our departments and of our divisions are shown in one return.

Q. You said that your divisions would not handle the sale of publications, but does not your national office handle the sale of publications?

A. The national office sells publications to our affiliated [fol. 57] clubs, which are over 250 in number, and also makes these publications available for our own divisions.

Q. And your advertising sales, what do they consist of?

A. The advertising sales are principally the sale of space

in our various national touring publications. For example, our tour books for various areas in the country are combination directories. We have quite a substantial amount resulting from the sale of space in those books.

Q. When are these various items taken as income, at the time it is billed or at the time it is received?

A. These various items are taken as income at the time they are billed.

Q. You have a magazine. How is that income handled, or is there any income from your magazine?

A. We have a magazine in the District of Columbia Division which is called "The American Motorist." Some of our other divisions have other publications which are furnished to them. The magazines in all cases, the publications in all cases are published for the use of the membership and there is no income from that source. It is part of the membership package.

Q. Do you bill your members for that separately or is that included in the membership fee?

A. The magazine furnished to the member is included [fol. 58] in the membership fee.

Q. You have various items of income either in your division or in your national headquarters. Are these items of income segregated or are they all placed in a general fund between the various banks?

A. Are you referring now to the funds that are collected?

Q. That's right.

A. The funds that are collected are placed in our bank in the name of the American Automobile Association.

Q. In a general bank account?

A. In a general bank account, yes, sir.

Q. Do you have any restrictions of how division funds can be paid out or used?

A. We have no restrictions on the payment of the funds that were deposited in our general bank accounts.

Q. Just to clarify the record, isn't it a fact that a dollar per member is set aside in some manner covering magazine subscription, or is that just for the Post Office?

A. No, sir, my understanding of the situation is that the Postal regulations require that the subscription price be

named in the publication, and that figure is mentioned in the publication itself and I believe it also is mentioned on the membership application, but we make no actual segregation of the payment.

[fol. 59] Mr. Kane: I don't believe I have any further questions at this time.

Redirect examination.

By Mr. Bomar:

Q. Mr. Cooper, you spoke of advertising revenue. Do the divisions have any substantial amount of advertising revenue as contrasted with the national headquarters of the American Automobile Association?

A. No, sir, the divisions have practically no advertising revenue in comparison with the total received by national headquarters.

Q. And I believe you have testified previously that a stated set of books and records is maintained for each division; is that correct?

A. That is correct, and a separate income and expense record is kept for each department at the national headquarters and for each division.

Q. And in so far as the schedules which you prepared showing the total cost, did they or did they not refer to the total cost only of the division as contrasted with the total costs of the entire American Automobile Association?

A. They referred only to the costs incurred by the divisions and do not include any of the costs charged in the interdepartmental operation.

[fol. 60] Mr. Bomar: That is all.

Recross examination.

By Mr. Kane:

Q. May I show you Plaintiff's Exhibits Nos. 2, 3, 4, 5, 6, and 7?

A. Yes, sir.

Q. I see that Exhibit No. 2 speaks of divisions only on the costs. Exhibit No. 3 does not tell us whether that covers

the divisions only or the national operation. As I recall it this total income figure in the first column is for the entire operation, speaking of $3,531,178.67.

A. Exhibit No. 3 and also Exhibit No. 5 would show the dues received relating only to the division dues.

Q. They relate only to the division?

A. It would have been clearer had we so stated at the top of the schedule, but they relate only to the divisions. Just as the costs shown in Exhibits Nos. 2 and 4 relate only to the division.

Mr. Bomar: The stipulation says it applies only to the divisions.

Mr. Kane: That's what confused me.

I have no further questions.

(Witness excused.)

Commissioner Bennett: This might be a good place to recess for lunch. We will stand in adjournment, then, until [fol. 61] 1:30.

(Whereupon, at 11:55 o'clock a.m., a recess was taken until 1:30 o'clock p.m.)

AFTERNOON SESSION

(1:30 o'clock p.m.)

Commissioner Bennett: Mr. Bomar.

Mr. Bomar: Professor Paton, please.

Whereupon—WILLIAM A. PATON, a witness produced on behalf of the Plaintiff, being first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Bomar:

Q. Would you please state your name and address?

A. My name is William A. Paton. My address is 2203 Hill Street, Ann Arbor, Michigan.

Q. What is your occupation?

A. My major activity is college teaching.

Q. And what is your present position?

A. My present position is Edwin Francis Gay University Professor of Accounting, and also Professor of Economics at the University of Michigan.

Q. Professor, how long have you served on the faculty of the University of Michigan?

[fol. 62] A. With minor interruptions I have served there for 44 years.

Q. And when were you made a full professor?

A. In 1921.

Q. Please describe briefly your educational background.

A. My undergraduate college work was taken at Michigan State Normal College and the University of Michigan. I held three degrees from the University of Michigan, including the Ph.D. granted in 1917.

Q. What was the subject of your doctoral dissertation?

A. The type of my dissertation was accounting theory with special reference to the corporate form of enterprise.

Q. Professor Paton, are you a Certified Public Accountant?

A. Yes, I am. I hold a certificate granted by the State of Michigan.

Q. Are you the author of any books; texts or treatises on the subject of accounting?

A. Yes, I am an author or co-author of 15 or 20 books and treatises. Perhaps the most important and best known among the textbooks are "Essentials of Accounting" first published in 1938, "Asset Accounting" published in 1952, and "Corporation Accounts and Statements" published in 1955. I might also mention that I was editor and the major contributor also to two editions of the Accountants [fol. 63] Handbook.

Q. Are you at the present time serving in any capacity as a consultant for the United States Government?

A. Well, I have one small connection at the present time in that I am serving as a member of the Educator-Consultant Committee, it is called, of the General Accounting Office.

Q. And do you now or have you ever served as a member of any committee of the American Institute of Accountants?

A. Well, yes, I served between eleven and twelve years as a member of the Committee on Accounting Procedure of the American Institute of Accountants, now called the American Institute of Certified Public Accountants. That, I think, is my principal assignment in that Institute.

Q. Professor Paton, have you, at my request and at the request of other attorneys in cases where you have testified as an expert witness on the subject of accounting, prepared a written statement which describes your educational background, your teaching appointments, the books and articles which you have written, the professional societies of which you are a member, your professional and business experience and other activities which are relevant to your qualifications as an expert witness on the subject of accounting?

A. Yes, sir, I have.

Mr. Bomar: Your Honor, at this time I would like to [fol. 64] offer as Plaintiff's Exhibit No. 8 this statement of qualifications of Professor Paton, and I would like to have him recognized as an expert witness on the subject of accounting in this case.

Commissioner Bennett: Have you seen the memorandum, Mr. Kane?

Mr. Kane: No, but I am familiar with Professor Paton and I have no objection to this going in evidence, and I recognize Professor Paton as an expert in the accounting field.

Commissioner Bennett: The statement is received. The witness qualifies.

(Document containing data regarding training and experience of Prof. William A. Paton was marked Plaintiff's Exhibit No. 8 and received in evidence.)

By Mr. Bomar:

Q. Professor Paton, have you read the petition filed by the American Automobile Association in this case, Government's answer, the agreed stipulation of facts, and have you

heard the testimony given by witnesses who preceded you in this case?

A. Yes, sir, I have read the petition and the answer and the stipulation and have heard the testimony that has been given up to date by the preceding witnesses.

Q. Are you familiar with the method of accounting em- [fol. 65] ployed by the American Automobile Association during the years in issue in accounting for dues received in advance from members of its divisions?

A. Yes, speaking rather generally, I would say that I am familiar with the method that has been employed by the Association.

Q. And are you familiar with the change in Plaintiff's method of accounting which the Commissioner of Internal Revenue seeks to force upon Plaintiff?

A. Yes, sir.

Q. Professor Paton, if the American Automobile Association is incorporated as a non-stock membership organization and finances its operations by means of dues prepaid for twelve months in advance by members of its divisions, and in return for such prepaid dues the American Automobile Association is obligated by contract or otherwise to render specified services to its members over the ensuing 12-month period following receipt of such dues, would it be proper, in your opinion, under generally accepted accounting practices for the American Automobile Association to treat as revenue or income in the year of receipt the entire amount of such dues even though the Club is obligated to render services to its members for a period which extends beyond the close of the taxable year?

Mr. Kane: Your Honor, before answering that question, [fol. 66] I want to interpose an objection to Professor Paton's testimony as an expert in this case, on the basis that I consider this testimony to be given in the form of an advisory opinion to the Court and that the issue before this Court is a legal issue rather than an accounting issue, and that any answer that he will give here today will be an advisory opinion, which we take the position is not proper matter for expert testimony, no more than having a lawyer testify as to what the law should be.

Mr. Bomar: Your Honor, in determining whether expert testimony is admissible, my understanding of the law is that first we must determine whether the matter under inquiry is subject to opinion testimony from the point of view of whether the issue involves an area where expert testimony would be helpful.

In my opening statement I called attention to the fact that the taxpayer is required to compute net income in accordance with the method of accounting used in keeping its books and records unless such method does not clearly reflect income.

I also call your attention to the fact that the statute, both section 42 of the 1939 Code, and section 451 of the 1954 Code, requires that all items of gross income shall be included in the gross income for the taxable year when received by the taxpayer unless the methods of accounting [fol. 67] permitted such amounts to be properly accounted for as of a different period.

It seems to me that no matter what the witnesses who I propose to qualify as experts testify in this case, it would have no bearing on the ultimate legal question to be resolved, whether tax law differs materially from generally accepted accounting principles.

Furthermore, there are numerous cases in which experts have been permitted to testify on the ultimate issue involved in the case, such as reasonableness of salaries. Experts are qualified from that view when that is the sole issue in the case, such as valuation of property and that is the sole issue in this case.

I think that the issue involved in this case clearly is one in which expert members of the accounting profession are peculiarly qualified to render competent testimony.

Commissioner Bennett: The objection is overruled.

Mr. Kane: May I have an exception, and the same throughout the testimony of experts, an objection and exception?

Commissioner Bennett: You may.

Mr. Kane: Thank you, Your Honor.

The Witness: No. It would not be proper.

By Mr. Bomar:

Q. And why not?

[fol. 68] A. It would not be proper because the procedure that you described is in conflict with an absolutely basic principle of accounting, namely, that we must distinguish between a financing transaction and revenue or income transactions. I regard that as pretty close to the cornerstone of accounting.

Q. What do you mean by a financing transaction?

A. Briefly a financing transaction is a transaction in which funds are raised by any organization or enterprise to get it going and carry on its activities. There are three main ways of doing it. Speaking of corporations and organizations generally, substantial funds are raised from stockholders. Another source, a second major source is borrowing at the banks or from other lenders. Third and actually quite an important source is that of advances by members or customers.

Many companies would utilize primarily the first two sources, acquiring funds from stockholders or from creditors such as banks and other lenders, especially in a membership, a non-stock organization, and I understand that the American Automobile Association is of that nature, it is not only commonplace but appropriate, one might also say, naturally to rely on the members for advances to get the funds necessary to carry on operations.

Q. What do you mean by a revenue or income trans-

[fol. 69] action?

A. A revenue or income transaction occurs when some organization, corporate or otherwise, furnishes a product or renders services and no revenue can emerge in the very nature of the case until product is furnished or services are provided. That I regard as an undisputable principle of accounting and it is universally recognized, as far as I know, in the accounting field.

Q. Professor, would you give us an example which would distinguish between a financial transaction or a revenue or income transaction?

A. Well, there are, of course, many examples in business

operation. I might be permitted perhaps to try my hand at a very simple hypothetical example in an effort to bring out what I regard as the underlying point involved.

Suppose, Mr. Bomar, that at about the end of a taxable year you deposited $100 with your tailor in connection with an order, which he has agreed to, to make you a nice overcoat at a cost of $300. Now, assuming that we are approximately at the end of his fiscal and taxable year—I don't know that it is even necessary to throw that assumption in—but at any rate when that transaction occurs you are depositing $100 with your tailor in connection with this order for an overcoat.

Proper accounting for a tailor would require the estab- [fol. 70] lishment of a liability account in your name for the amount of that $100 which you deposited with him as a means, perhaps, of helping to finance his purchases of materials and other costs to be incurred in the making of this coat. He is just in the same position substantially as if he had gone to the bank and borrowed $100 or you had signed his note at a bank for $100.

Now, if that is the situation still at the end of his taxable year, it is absolutely essential that he show a liability to you of $100 in his financial statement and it would be absolutely incorrect for him to treat that $100 as an income item.

Now, in the following year when he makes up the coat, buys the material and makes up the coat, he now has a revenue transaction, and the proper accounting for that would be to recognize a revenue or sale, as we often say, of $300 and a charge to you as a customer of precisely that same amount.

Now, we have arrived at the final stage of settling these two claims, your claim against him for the advance of $100 and his claim against you for providing you with a product, this coat, at an agreed price of $300.

Now, two methods of settlement are open to you: You mght pay the tailor $300 and then he might pay you $100, returning the amount of your advance, which, if he had [fol. 71] borrowed from the bank, that is what he would do. Or instead of that he may deduct the $100 claim in your favor from the $300 claim in his favor and bill you

for $200. That's precisely the way that invoice would be typically set out, but that does not alter the fact that in the first year we have a financing transaction in which you provide the tailor with $100 in just as clear-cut way as if he had gone to the bank to get it, and that remains a liability, I assume, at the end of the year, and the second year revenue emerges and the settlement of these claims also develops.

Q. Professor Paton, can you or not apply the principle of accounting you have discussed and illustrate it to the facts in this case?

A. Yes, I think I can as I understand the facts.

It seems to me that my little example is absolutely on all fours with the facts in this case, that when a member makes a deposit of any amount of money in advance of the rendering of service by the association, or one of the constituent branches has agreed that we have no revenue transaction, there is no such thing at that stage as revenue or income. Instead we have a bit of financing and I don't regard it of any consequence whatsoever that the amount advanced might be quantitatively or equivalent to a year's dues. I think it is at that point some people get confused about such cases.

[fol. 72] The plain fact is that at that point the Association has incurred a liability, the Association has received funds from members in lieu of other methods of financing. Now, as through the passage of time the Association renders services as agreed, the revenue transaction emerges, and under prevailing practice an arrangement is worked out under which the liability is discharged instead of a payment by providing service as agreed. That doesn't alter one iota the fact that one transaction is raising funds and the other transaction is the revenue transaction.

Q. Professor Paton, does sound accounting practice demand that there be a distinction between the receipt of advance dues which you described as a financing transaction and the rendering of services which you describe as an income or revenue transaction?

A. Yes, it certainly does. First, I perhaps have already said I consider it a basic principle of accounting practice

to draw that distinction, and I think it is universally acknowledged among accountants. I don't know of any reputable accountant that would hold anything to the contrary, and I think that is true for a long period of years.

Q. Professor Paton, the pleadings in this case make it clear that the American Automobile Association uses the [fol. 73] accrual method of accounting. Under the accrual method of accounting, is it essential that income be recognized only as services are rendered or made available?

A. Yes, it is, but I would like your indulgence to clear up something there.

In my opinion it doesn't make any difference whether the taxpayer is on the so-called accrual basis or on the so-called cash basis, as I understand the situation. Whichever basis he is on it is absolutely improper, it is unsound accounting for a taxpayer to treat money secured at the bank as if it were revenue or money secured, with which to operate, from members, as if it were revenue.

My understanding of the cash basis of accounting—and I am subject to correction, because I think I know something about this—but we do have a system under which the taxpayers—we refer to the taxpayer in that category here—is permitted under some types of circumstances to defer the recognition of revenue that has already been earned and produced until cash is received.

I report my return on the cash basis. I report the cash paid to me each year as my cash income.

Q. Professor Paton, if receipts in the form of advances by members or customers are treated as taxable income entirely in the year of receipt, is there a possibility that taxable income over a period of years will be overstated [fol. 74] and that the total tax collected from the particular taxpayer will exceed the statutory rate applicable and may even include a levy on capital funds in the guise of an income tax?

A. Yes, there is very clearly such a possibility. I might take perhaps a rather extreme example that is not literally identical to the case we are considering, but it seems to me it is the same principle. Let's suppose a new company was organized to make machine tools or some other products and the funds to build the buildings, let's say, were

secured from the stockholders and funds to buy materials were secured from some interested customer who has ordered quite a number of these units of product that the company is going to make. Now, if a part of the money advanced by that customer who is making these orders were seized as income taxes, not only would we be taking money obviously raised to acquire these inventories but we would be taking money before we know whether the company is going to be able to operate at a profit.

You would seize funds that are being used to finance a business prior to the production of revenue and the assembling of the costs, and you may very well have a tax levy when there is literally no income at any point.

If, for instance, the price that was agreed upon for this customer I am thinking of weren't high enough to develop [fol. 75] some of the cost that might unexpectedly appear, it might be that the company would operate at a loss. It seems to me that in such a situation it would be ridiculous to take some of that money and call it income.

Q. When in your illustration would the income for revenue purposes take place?

A. When the goods are provided for the customer as agreed by the contract.

Q. Professor Paton, when you refer to an income or a revenue transaction are you referring in general to items which appear in a profit and loss statement, or are you not?

A. Yes, in a profit and loss or income statement. I prefer the term "income statement," but it doesn't matter and I am using them both because sometimes we find the term "revenue" and the "total sales price" and sometimes we apply the net income to a net or intermediate figure, but the elements I am thinking of are income statement elements, yes, sir.

Q. Professor Paton, can the error which you described in accounting in the case of the machine tool manufacturer happen to such an association as the American Automobile Association?

A. Well, it seems to me it clearly can. I don't know the details of the Association, but it seems to me they clearly can.

[fol. 76] If I might try to focus on something to bring out the point, let's suppose, for instance, that the Association toward the end of a taxable year staged quite a membership campaign and got quite a bit of money in toward the end of that year covering membership so that can operate as of the first of the following year. It might well happen that unexpected developments may create an element of cost when the Association undertakes to furnish the services or provide the services for the membership as agreed, a level of cost might emerge that would wipe out any possible income margin with respect to this batch of customers during the year in which revenue were being produced and costs being incurred. In fact, I would be surprised if that sort of thing wouldn't happen from time to time wherever funds are levied upon in the gross prior to the incurring of costs or the creation of the revenue itself.

Q. Professor Paton, you will note from the agreed facts in this case that the American Automobile Association recognizes advance dues as revenue or income as services are made available over a period of time of the membership. Will you please state whether or not there is any justification for recognizing as income or revenue advance dues on a time basis?

A. Well, it seems to me there is considerable justification. The contract itself is on a time basis. I feel espe-
[fol. 77] cially for tax purposes the important thing is that the year's recording be handled in such a way that for the year the transactions with members are treated soundly, as I have tried to suggest. The time basis does not offend me at all. I would doubt if there is any other basis that is more realistic, especially when you consider the practical side of it and the way the thing is regarded by both the Association and the member.

I might say I am probably one of the oldest members of the Michigan Automobile Association and it is my understanding when I deposit my dues that over a stated period of time the thing that I am acquiring is the right to receive a series of services of one sort or another specified in the arrangement, and hence proration over a time, as time

passes, strikes me as being perfectly realistic and reasonable.

Q. Professor Paton, Mr. Arthur I. Cooper has testified that even had advance dues been pro rated as costs were incurred on an average cost per member per month basis, that the recognition of revenue during a particular year and the amount of the liability as of the end of the year would not have been materially different than if revenue is recognized out of the advance deposits on a time basis. Would that testimony fortify your conclusion that time is a proper yardstick for measuring the obligation that the [fol. 78] American Automobile Association is performing or the expiration of its liability to render services?

A. Yes, I think it would to some extent. That is, I would be inclined to recommend that such study be made from time to time just as a means of seeing whether the relationship can be properly recorded on a time basis.

My feeling still is that time basis is thoroughly sound and that cost data of the kind presented that I was listening to this morning, are primarily important for the purpose of testing the general reasonableness of the time basis and seeing whether there is anything uncapricious or outlandish about such basis.

Q. The feeling has been expressed by others that such a method of accounting would be artificial if advance dues were recognized on a time basis unless it was proved that the relationship between the income and services be rendered. Do you agree with that view from the accounting point of view?

A. No, I don't agree with that point of view or any other point of view as far as understanding the operations of an automobile club or an association, though such understanding as I have, if anybody can find a better basis I would like to see them do it.

The Club, the Association, by contract agrees to provide a package of services and conditions. Now, fluctuations [fol. 79] between months, if there were such, wouldn't frighten me particularly, because I would be looking back as a whole, and I think time is a very good and realistic basis for saying that the Club has undertaken to provide a package of services over a period of time, but I don't

object, on the other hand, to studies which I think should be made from time to time to test things out and see how other aspects of the situation fortify or raise questions about the time basis. I wouldn't want to insist here the time basis is the only basis with which one might spread the revenues of a service organization.

Q. Professor Paton, if you were employed by the American Automobile Association as an independent expert to advise them how to set up their books and records in order to reflect and recognize advance dues on a proper basis, what method would you recommend?

A. Well, I might quibble a little bit about the account titles, maybe prefer something a bit different, but I would emphatically recommend that the Association's usual method of accounting which sets up at the end of each year on a reasonable basis the outstanding obligations to members as a liability and to recognize revenue as services are rendered or made available through the year. In fact, I can't see any justification for anything else. Now, I understand that is what the Association has been doing for [fol. 80] many years, and if my understanding is correct I wouldn't have any quarrel with them on any essential points whatsoever.

Q. Professor Paton, is the method of accounting for advance dues which the Commissioner of Internal Revenue seeks to impose upon the American Automobile Association in accord with generally accepted accounting principles?

A. No, sir, it is not. It is absolutely 100 per cent in conflict and always has been where it has been tried, and I might add it is entirely indefensible. It should not even be considered debatable, and I was disturbed for many years handling this correctly, in income tax and other connections we started trying to do the wrong thing.

Q. Professor Paton, I call your attention to page 282 of the book to which you have referred, "Corporation Accounts and Statements," wherein you write:

> "The term 'deferred revenue' is sometimes applied to balances representing amounts collected from customers or clients in advance of the delivery of goods

> or the furnishing of service. As emphasized later, such balances are liabilities, not revenue credits deferred or otherwise."

Does the statement which I have quoted apply to the account entitled "Deferred Revenue—Membership Dues" referred to in Paragraph 7 of Plaintiff's Petition?

A. Oh, yes, clearly that is an example of the very kind [fol. 81] of situation I have in mind there, but those balances are clear-cut liability balances and I personally prefer to describe them as advances by customers or something of that kind rather than just a particular type.

Q. I also ask you to turn to page 416 of the same book, of which you and your son are the authors, and in which you write:

> "A type of liability frequently misinterpreted is represented by 'unearned' or 'deferred' revenues so-called . . . the proper general caption for such item is 'Advances by Customers' and that should be reported in clear-cut fashion under liabilities."

You continue on page 417:

> "In a number of cases the Internal Revenue Service has taken the almost incredible position that advances by customers constitute revenue for tax purposes in the period received, even if the taxpayer's accounting is on a strict accrual basis and even if no goods or services have been delivered in such period."

Is this still your view?

A. It most certainly is and it always has been, I might say, as we considered this a very elementary point in accounting, and I have never heard of anything ever being preached in a classroom or anywhere else.

[fol. 82] Commissioner Bennett: You have taught it that way for 44 years?

The Witness: Yes.

Commissioner Bennett: And when was your book published from which the quotation has been made?

The Witness: This particular book, Your Honor, was published in 1955, but you will find the same material I have written with the exception that in most of them you won't find this book at the Internal Revenue Service.

By Mr. Bomar:

Q. Professor Paton, we have been talking about the income account of the Association primarily. I want now to direct your attention to the balance sheet as contrasted with the income account. The balance sheet of the American Automobile Association is evidence in this case established here and always as a liability account, which is referred to as "Deferred Revenue Membership Dues." Does sound accounting practice require this amount to be shown as a liability on the balance sheet of the American Automobile Association?

A. In my judgment it most certainly does. It is a liability.

Q. Professor Paton, would you as a certified public accountant certify to the accuracy of the income statement or the balance sheet of the American Automobile Association if the Commissioner succeeds in changing its method of accounting?

[fol. 83] A. No, I certainly would not even consider it for a moment. The thing is unsupportable and I wouldn't know offhand of any professional accountant who would say differently.

Mr. Bomar: Thank you, Professor Paton.

Mr. Kane: May we have a short recess, Mr. Commissioner?

Commissioner Bennett: We will take a ten-minute recess.

(Short recess taken.)

Commissioner Bennett: Proceed.

Cross examination.

By Mr. Kane:

Q. Professor, you talked about the accrual method of accounting and deferred revenue or deferred receipts method. In normal accrual accounting, as I understand it,

you take into account the amount when it is billed to a customer whether or not at that point you have rendered the service to that client; isn't that right?

A. No, sir.

Q. It is not right?

A. No, sir.

Q. In other words, if I go to a store and purchase a suit in late December which is not furnished to me until some time in January, the store bills me the 30th of the month, the 30th of December, they do not accrue that as income in December?

[fol. 84] A. I couldn't guarantee that there is no store that does not violate the principle, but that is something we are very touchy about in accounting. That would not be correct accrual accounting for revenue to be credited—you used the word there—in December with a sale in which the furnishing of the product doesn't occur until later.

Now, there is one possible exception to that, sir. If the circumstances were such that the coat was already in existence and was segregated as the property of the customer, it is the exception but I don't think we need refer to it in the retail situation, but there might be instances the fact that the product had not physically left the possession of the vendor would not be the decisive thing provided the product is there waiting delivery and all the conditions have been taken care of. For instance, a wholesaler might order a big shipment of cans from a canning factory for canning tomatoes, let's say, and if the customer had those tomatoes on hand and set them aside as the property of the customer, I would be willing to say that under some of those conditions you do have a revenue transaction and that the billing is validated by a revenue transaction. But, speaking generally about manufacturing and trading companies, I would say that the last thing in the world any of us would tolerate in accounting would be the inclusion in revenue in the current year of prospective sales even though normal billing or formal billing had [fol. 85] been instituted.

Q. If they billed me in December and the coat was delivered to me in December and I did not pay for it until

some time in February or didn't pay for it at all, when would it be accrued as income?

A. In that situation the revenue would be recognizable under proper accounting in the month of December regardless of the fact that the transaction might turn out to be a bad debt. In other words,—

Q. An adjustment would be taken in the following year as a bad debt?

A. The bad debt loss would occur later when the account went sour.

Q. Professor Paton, you called these dues, in effect, advances from the members. Now, you also said, I believe, that advances are usually thought of as subject to a service being performed or a refund being made if the service is not performed. I believe you used a hundred dollar example.

A. Yes, I didn't say specifically anything about refund.

Q. But I am asking you about refund.

A. Okay.

Q. I think it follows in the same order. Do you know if the dues in this case are subject to refund?

A. I don't know for certain about that, sir:

[fol. 86] Q. May I ask you do you know as a member of the Michigan Automobile Club, which you say you have belonged to for many years, whether there are or have been years in which you required no service?

A. There have been years in which I did not require them to pull me out of the ditch or anything of that kind, but I do not consider that is what I am paying for. I am buying the availability of the service, I am buying the protection and that is what I am paying them for when I take out membership. I hope they will not have to pull me out of the ditch, in fact.

Q. The same as insurance?

A. I consider it a very close relationship between an insurance situation and this type of situation with regard to the type of product.

Q. But it is conceivable they have a few cases, a few members or many members who ask for nothing as an item of direct expense to the organization during the fol-

lowing year. I am not talking about overall management salaries but pulling a man out of a ditch, asking for travel folders. Is it possible there would be many members that would ask for no service of that type during a year?

A. Oh, yes, I think that is clearly involved. You are dealing with a group or pool. Any pooling or risk situation, particular members may in a particular year require [fol. 87] very little of a specific service that is rendered to certain other members. I wouldn't know what the experience on that would be, but I would think it would be rather irregular between individual members.

Q. But your fixed liability as you see it in contrast to the overcoat transaction is their being liable to render these services?

A. Well, I have always understood that is what I am buying and that is the regular understanding that I am buying the availability of services, the protection and paying for it reasonably, and I hope I won't have any bad luck.

The specific intentions, they are agreeing to furnish certain services—there is a considerable difference, I might add, on varying types of business of that kind. Frankly, the irregularity of the actual furnishing of the maps and helping you out when you run out of gasoline and so on, I frankly don't think that has a blessed thing to do with the over-all accounting.

Q. Now, this view of others that you mentioned you took issue with, would you mind clarifying for the record whose views they are?

A. I was asked, I believe, a question to this effect, that there are others who regard the recording or recognizing of service on a time basis as artificial. There was nothing mentioned as to who these others are in question, but my [fol. 88] answers simply were if there are folks of that stripe I don't agree with them.

Q. It might be the Supreme Court?

A. Are you asking me, sir?

Q. Yes. You heard the testimony this morning and the opening statement?

A. Yes. I am not familiar with the details of the Michigan case, but I am quite sure I saw reference to it in the papers originally and I heard what was said here today

and have some little familiarity with it, and I don't know what facts were presented to the Court, but on this particular point we have under consideration here now the Court reached absolutely the wrong decision.

Mr. Kane: That is the reason for my objection to this type of testimony, Your Honor, it is an advisory opinion.

By Mr. Kane:

Q. Now, there were some charts shown here about expenses. You said that you believe that the proper method was to pro rate on a time basis the dues, that expenses as I recall it would be for testing purposes from time to time to see how your system was working out. Is that a fair statement?

A. Yes, that is my recollection. I just add this word, that I consider the basic question I have been addressing myself to, this question of making sure we have a liability [fol. 89] appropriately calculated set up at the end of each accounting period and that the revenue transaction and the services rendered be recorded over a period of time in a reasonable way.

Now, I don't hold any rigid plea for a strict time basis. It looks to me as though it is the most realistic and practical and sensible and strict situation.

Q. You would say, then, that it wouldn't be proper to prorate expenses over the same year?

A. No, I wouldn't say that.

Q. You would not say that it was not proper to prorate expenses?

A. No.

If I might elucidate very briefly on that. The accounting that is on an income statement, I regard in this way: The measure of the revenue up at the top of the statement I think is a relatively simple thing. The determination of the costs that are perfectly applicable to that revenue is a much more controversial subject. I don't think we in accounting do as good a job in that area in general as we do in the area of simply setting up the revenue figure at the top of the income statement, but I am a thorough-going

believer in our perfecting our charges for deductions in so far as it is feasible and practical to do so, so that we have a reasonable relationship between the charges and the [fol. 90] revenues.

Q. I believe you testified that in effect this method that the Commissioner advocates would at times result in his taxing as income either capital or loans not actually earned; is that correct, sir?

A. It seems to me it is quite likely to result. You are levying a tax upon receipts that in the first instance are funds advanced to finance activities, so you are levying a tax to start with on a gross figure. It seems to me quite possible, quite likely in fact, that from time to time the levying of a tax prior to the creation of a revenue and the expense accounting will result in seizure as income taxes of funds that are not income in any sense of the word.

Q. Now, that is from time to time, in other words, not just at the beginning of the business but from time to time to put some changes in the number of memberships that will occur?

A. Yes, unexpected changes in expenses, loss periods and so on. Now, I haven't worked out any examples to my satisfaction in detail in that area, but that's my impression, and, of course, we can see at the beginning of a business, we can see the thing more clearly, but what I do from time to time say, that that situation would arise after the operating history, after you got rolling presumably from time to time. But I don't think we can hope that there [fol. 91] will be a coincidence from year to year between the advances by customers and any organization that utilizes that method of finance and the volume of service and product produced in that year. That would be a sheer coincidence if they are identical. That creates the possibility of levying taxes on funds that not only are not income to start with but will never be in any sense of the word an element of net income.

Q. Now, continuing that, as long as you have a curve upward of members and you are prorating part of the income into the next year for the revenue, gross receipts, wouldn't it follow that if the expenses were increasing to serve more members that you would be putting in part of

the expenses in the latter months of the year, you would be increasing the expenses so that your net income would always be less as long as you have an upward curve of members?

A. I am not sure I follow you. I don't see anything about an automobile association, or, for that matter, any other business which deserved the general conclusion that there will be a trend upward of revenues or a trend upward or downward of expenses. That would depend on a lot of circumstances, but, to my mind, sir, there is a fatal effect in taking money as income before income emerges, in that you have deprived the taxpayer of funds too early, and in the second place you run the risk, but even year by year there will be substantial injustice done. That's a question [fol. 92] I think you would have to postulate a lot of facts rather carefully how it would work out.

I am not trying to evade your question, but I don't know the answer.

Q. My question is premised on exhibits put in by the Plaintiff, and I note that each year's expenses have gone up anywhere from three or four hundred thousand dollars to over a half million dollars in an exhibit right here, and my question is premised on the fact that some of those expenses during those years may have been applicable to the new memberships, the income from which is being turned over into the next year under the Plaintiff's method of accounting.

A. Oh, I think that is quite possible, that some of the costs that are incurred and are recorded as expenses currently by the Association, that we could find fault possibly with some treatment there. I wouldn't think in the automobile association business that they would be as serious as we might find in manufacturing and some other cases, but I would recommend, as I understand the Association follows, the practice of spreading the commissions to salesmen, because they relate to a particular element received from the members.

Now, I wouldn't, on the basis of any information I have, want to be either critical or applaud the general treatment of this and that cost like office supplies and salaries of [fol. 93] stenographers and others. I don't know of any-

thing strikingly wrong about that area of accounting for the Association, but I can't testify to the advantage or disadvantages of the things they are doing.

I said a little while ago, and I would like to refer to that in the field of determining the cost assigned to the volume of sales or services rendered, we do have a lot of difficult accounting questions.

Q. Why would you say that the salesmen's commissions that you just referred to are more direct expense than publications, road service or any of those things, other expenses incurred for a member?

A. Well, I don't know that I know enough about the operations of the Association to speak very positively on that, but it does seem to me that the commissions specifically related to amounts advanced by customers, that there should be some justification for spreading through the year by months especially if you are going to spread services rendered by months through the years, and wherever anything of that kind is substantial, I think you include your accounting somewhat by appropriate spreading.

Now, when you come into the field of publication costs that is something like the question of advertising in business generally. I remember when I was in the Internal Revenue Service 40 years ago for a year, that we were [fol. 94] worrying about advertising cost, whether we should permit advertising cost as a deduction in the year in which the money was spent or the billing occurred, like some late advertising in the Saturday Evening Post, say, about this time of year, or whether we should try to insist on some method of deferral and, generally speaking, the method of deferral. You didn't try to do much with it because of the great difficulty in deciding when the results of some of these expenditures might be. Now, publication expense, I don't think I should pass judgment on that. I don't think I know enough about it, Mr. Kane.

Q. You gave as the only thing they now prorate is the salesmen's commissions.

A. Yes.

Q. In this case.

A. One other thing, I think it was mentioned the cost of accident insurance was prorated also.

Q. Yes, accident insurance. No, it is not prorated.

A. I understood it was and always had been.

Q. You heard some testimony this morning as to the change in 1954, which is the same thing we are talking about, and there was also mention of items on the books as of the end of the year, a small figure, roughly $44,000, which they treated as an accounts receivable in a memorandum form only, which was not placed on the books. Would [fol. 95] you say that proper accounting as described this morning would require them to include that or a portion of that $44,000 in their income for 1954 when they had been doing it each year up until then?

A. As I understand the change, and I may not be entirely clear on this, but as I understand the change it would not result in inconsistent accounting or any material change, because I would regard accounts receivable that had been set up at the time the application is received and no funds had yet come in as a sort of memo account and the corresponding credit in deferred revenue account or whatever you call it, I would call an offset and I would say the offset was a change in these two methods of accounting. That would seem to me preferable to what they would be doing previously and not inconsistent with it.

I am not undertaking to say that an accountant from absolutely every standard knows anything about it, but I don't see that that particular change is substantive to the matter I have been addressing myself to here.

Mr. Kane: I have no further questions.

Redirect examination.

By Mr. Bomar:

Q. Professor Paton, Mr. Kane asked you your opinion as to whether the American Automobile Association had a practice of making refunds to members, and as I recall your [fol. 96] testimony you stated that you didn't know. Would it make any difference under sound accounting practices from the viewpoint of distinguishing a financing transaction from a revenue transaction whether the Club does or whether the Club doesn't make refunds?

A. I don't think so. It is an incidental thing which would draw a little distinction advanced by a customer and a member and a bank loan, but if in incidental cases refunds were restricted or were not available it doesn't seem to me that alters the basic proposition that the money advanced by the customer is an advance and is not revenue.

Now, some subsequent development might involve some small adjustment, I don't know, but I think I can state that pretty clearly and flatly that I can't see that that fact settles the question at all of what is a revenue transaction there and what is a financing transaction. To me the advance by the member is the provision of some funds prior to the emergence of revenue.

Q. Professor Paton, under sound accounting practices is there any point in deferring expenses or in postponing the deduction for an expense unless it is a truly prepaid expense?

A. Well, that is a big question, Mr. Bomar. I think that the association of expenses with revenues is a difficult [fol. 97] question and involves many debatable points, because what we are really after is economic associates, and the word "prepaid" is a little bit restrictive to cover all such cases.

Q. Professor, is it debatable as to whether the advance dues should be deferred?

A. In my judgment it is not debatable and never has been.

Q. Professor, are you stating that even though no expenses are deferred, that you should still distinguish between advance dues and the recognition of dues as income?

A. There isn't any question in my mind but it is improper accounting to treat as a revenue, advances prior to the rendering of service, and that in itself—I amnot going to condone any bad accounting for expenses by saying that, but that's a distinct, basic consideration in getting started with your accounting at all.

Mr. Bomar: Thank you.

Recross examination.

By Mr. Kane:

Q. Didn't you say that the normal advance for loan as we think of it would indicate the right to a refund if the service was not rendered?

A. It depends on the way the contract is drawn, but I think of the person or entity receiving such advances from [fol. 98] customers and members as incurring an obligation and the proper utilization of those funds or the return of such funds, and I don't know enough about all the types of contracts we have in this area just to know when a refund is in order.

We know sometimes in the fire insurance business you are entitled by agreement and sometimes by request to a refund, so that generally speaking the producing entity does unquestionably incur the obligation. Now, what the basic law is I couldn't say.

Q. We are not asking you the law, Professor. Wouldn't you say that is true in subscription income, that normally if you cancel your subscription, like a newspaper subscription, that you are entitled to a refund?

A. I was under the impression that quite frequently you are not.

Q. On a long-term contract?

A. That I am not sure of. If you had a four or five-year subscription—my impression is that those contracts usually provide that you are not entitled to a refund, but what the practice is I couldn't be positive.

Mr. Kane: I have no further questions.

Commissioner Bennett: Thank you, Professor. You may be excused.

(Witness excused.)

[fol. 99] Mr. Bomar: Mr. Baker, please.

Whereupon—GEORGE E. BAKER, a witness produced on behalf of the Plaintiff, being first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Bomar:

Q. Please state your name and address.

A. George E. Baker; Rosecroft Road, Manor Club, Rockville, Maryland.

Q. What is your occupation or profession?

A. I am a Certified Public Accountant and a resident partner in charge of the Washington Office of Ernst & Ernst.

Q. Would you please describe briefly your educational background, Mr. Baker?

A. Bachelor of Arts Degree from the University of Wisconsin, and a major in accounting.

Q. How long have you been a Certified Public Accountant?

A. Since January 1941 in Ohio, and at the present time in the District of Columbia and several other states.

Q. Please describe your experience as an accountant, how long and where you have served as an accountant.

[fol. 100] A. I started with Ernst & Ernst in 1936 in Cleveland, went to Dayton, Ohio as manager in 1950, to Washington as manager in 1953. I was made a resident partner in 1954.

Q. Mr. Baker, it has been testified that Ernst & Ernst were the independent public auditors of American Automobile Association during the years in issue in this litigation. Who in the firm of Ernst & Ernst was in charge of that audit?

A. As manager of the Washington office I was in charge, general over-all supervision.

Q. Mr. Baker, did you issue a statement in connection with the independent audit to the effect that during the years 1953 or 1954 the net income of the Association computed in accordance with the method of accounting described in Paragraph 7 of Plaintiff's petition was in accord with generally accepted accounting principles?

A. I did, yes, sir.

Q. Mr. Baker, if the Commissioner of Internal Revenue succeeds in forcing the Plaintiff to change its method of accounting so that it is required to report advance dues as income in the year of receipt, would you or your firm certify the accuracy of the profit and loss statement of the Association?

A. For the year 1954 that would mean a distortion in the balance sheet of about $1,600,000 reduction of liabilities [fol. 101] and increase in surplus, and that would be such a substantial distortion that we would either not issue a report or if we did, deny an opinion.

As to the profit and loss statement, it would mean a difference of $200,000 or $300,000 in income difference between prepaid subscriptions and the end of the year, and that, again, would be so substantial and so much in variance with generally accepted accounting opinions, that we would not render an opinion, would deny an opinion for it.

Mr. Bomar: That is all.

Cross examination.

By Mr. Kane:

Q. You would deny an opinion. Just exactly what does that mean?

A. We render what we call an opinion as to the statements as to the facts, that they present fairly the financial position of the corporation or association and the results of its operations in the year under review. We do not longer use the word "certify" when we deny an opinion, we state why the statement contains certain items on the statement with which we do not agree and we cannot give our statement that the statement fairly presents a true condition or the operation of its operation.

Q. If this case were decided adversely by the Courts, you just would not render an opinion?

[fol. 102] A. That's right.

Q. And this would go on until the law was changed or forever?

A. Well, the courts do not dictate to us as accountants

what we shall show, unless it is an accounting case. This is a tax case.

Q. But from an accounting standpoint if they add up to higher taxes, then, not being an accountant, it would seem in their statement it would be less income.

A. Yes, sir.

Q. And that would show what they actually had, would it not?

A. It would show a tax very large in proportion to their true income based on generally accepted accounting principles.

Q. Rather than an opinion you would just give some footnote as to why it was done this way, you did not agree with it but it had to be done this way?

A. You are talking about increase in tax only?

Q. The entire balance sheet or financial statement.

A. If we revert to this position the Commissioner is trying to impose upon us now, we would deny an opinion, as I said before.

Commissioner Bennett: You don't give an opinion unless you can prove it?

[fol. 103] The Witness: That is correct. They are company statements, sir. We cannot force the company to change their statements but we can render or deny an opinion.

Commissioner Bennett: You never say why you don't give an opinion, you just don't give it?

The Witness: No. We generally do say why we do not give an opinion.

By Mr. Kane:

Q. You have heard the testimony here this morning and are familiar with the accounting in both 1953 and 1954?

A. Yes, sir.

Q. Do you feel there is any difference between the accounting procedure employed between 1953 and 1954?

A. There were some differences in the methods of handling specific items. I would say they were not in any sense a change of accounting principles, they arose as a result primarily of a survey we have been making of the

accounting methods of the Association. There were differences in handling specific items. They were, we thought, improvements in handling specific items. We can't go along year after year doing everything exactly the same when there is actually a need for improvement.

Q. I think the Commissioner has heard enough of this item to take a minute to [redacted] an explanation for the record of this change in so f[redacted]any one instance which we [fol. 104] have discussed, but also how you changed in so far as income is concerned. The one-twenty-fourth and the 50 per cent. Will you explain that?

A. The membership income, income for memberships?

Q. Yes, sir.

A. Prior to 1954 the method used to spread that income over practically every case for a year was to credit it all to deferred income, a liability account, and then we took into income 1/24th of the amount the first month, 1/12th the amount the succeeding 11 months, and 1/24th of the amount again on the 13th month, which seems a reasonable way of spreading it over a year.

However, again as a result of this survey recommendations were made to simplify that procedure. We made some reviews of what the effect of the simplification would be and discovered the over-all effect, as far as the year would go, would be practically negligible, so we changed over to a method where we took 50 per cent of each month's memberships receipt in the income, immediately deferred 50 per cent until the following year.

Is that clear?

Q. Just one more question.

Was that the prior method you used when it was billed 1/24th?

A. In the case of new memberships is when it was billed, [fol. 105] 1953 and prior.

Q. I thought I heard that said.

A. I am sure you did.

Q. You didn't feel that this change would require a request of the Commissioner to change?

A. No, we did not consider this a change in accounting method, of accounting principles, no, sir.

Mr. Kane: That is all. Thank you very much.

Redirect examination.

By Mr. Bomar:

Q. Mr. Baker, would you state whether or not the basic method of accounting employed by the American Automobile Association during the years you were in charge of supervising the audit of their accounts, whether that basic method of accounting was followed consistently?

A. Yes, it was followed consistently.

Mr. Bomar: That is all.

Commissioner Bennett: Thank you, Mr. Baker. You are excused.

(Witness excused.)

Mr. Bomar: Mr. Bell, please.

Whereupon—S. ALEXANDER BELL, a witness produced on behalf of the Plaintiff, being duly sworn by said Commissioner, was examined and testified as follows:

[fol. 106] Direct examination.

By Mr. Bomar:

Q. Please state your full name and address.

A. My name is S. Alexander Bell. I reside in the City of Chicago, at 2150 North Cleveland Avenue.

Q. And what is your occupation or profession?

A. I am a Certified Public Accountant. I am a partner in charge of the insurance department of Peat, Marwick, Mitchell Company.

Q. Please state whether or not you have passed the bar examination.

A. Yes, I was admitted to the bar in 1934.

Q. Please state whether or not you are a member of the Fellow of Actuaries.

A. Yes, I am associated with the Conference of Actuaries in public practice.

Q. Please describe your duties as a partner in the accounting firm of Peat, Marwick, Mitchell Company.

A. As I said, I am a partner in charge of all insurance assignments, which also includes the motor club, throughout the United States, with headquarters in Chicago. In other words, all insurance engagements of any nature, audit, consulting or procedural, tax, et cetera, are under my general supervision.

[fol. 107] Q. Why are motor clubs associated with insurance companies under your general supervision?

A. Well, the firm had two reasons for that: First, we considered the motor club business protects of the nature of insurance and closest to it, and, second, I have had most experience in the form of motor clubs.

Q. Have you as a Certified Public Accountant had experience in auditing the books and records of other motor clubs?

A. Oh, yes.

Q. Would you state whether or not the method of accounting followed by the American Automobile Association is a customary method of accounting in the motor club field?

A. Yes, it is. It is employed by all the motor clubs with which I am familiar.

Q. Mr. Bell, how many years have you practiced public accounting?

A. Well, I started in public accounting in 1929 as an employee of a public accounting firm in Chicago by the name of Winter & Company.

In 1933 I opened my own office under the name of Alexander Bell & Company, from 1933 to 1955. In 1955 I moved my office into Peat, Marwick, Mitchell Company, and became a partner in that firm of Peat, Marwick, Mitchell Company.

[fol. 108] Q. How large was the firm of S. Alexander Bell in terms of merger, in terms of Certified Public Accountants or number of employees?

A. If I remember correctly, we had altogether 46 employees when we merged. That included everybody. We had five CPA's and I don't remember the exact number of staff personnel or clerk personnel, but we had considerable number of them.

Q. Mr. Bell, does the firm of Peat, Marwick, Mitchell &

Company now audit the books and records of the American Automobile Association?

A. Yes, we were engaged to do so in 1957 starting for the year 1958.

Q. Are you familiar with the petition in this case, the Government's answer, the stipulation of facts and testimony which has been given in this case prior to this time?

A. Yes, I familiarized myself with the petition and all the rest of the exhibits.

Q. Will you state whether the accounting methods employed by the American Automobile Association in connection with the advance or prepaid dues are in conformity with generally accepted principles of accounting?

A. Yes, they are definitely in conformity with generally accepted accounting principles.

[fol. 109] Q. And are they not in conformity with generally accepted accounting principles in the motor club field?

A. Yes, the same. They are the principles which all motor clubs that I know of use in allocating their income.

Mr. Bomar: Your Honor, I would like to ask at this point that Mr. Bell, based upon his tremendous experience in the accounting field and with this large accounting firm be recognized as an expert on the subject of accounting in order that he can express opinions in this field.

Mr. Kane: Your Honor, I do not object to his qualifications. In fact, I am sure he is qualified as an expert, but I still take the same position about the expert testimony in this case.

Commissioner Bennett: Very well. Proceed.

By Mr. Bomar:

Q. Mr. Bell, will you state whether in your opinion the method of accounting which the Commissioner seeks to impose upon the Plaintiff in so far as the advance dues are concerned is a proper method of accounting?

A. No, I don't agree with that. I think it is the wrong method of accounting.

Q. And why is it wrong?

A. Because it is in conflict with generally accepted accounting principles which require the segregation as Professor Paton testified here of the financing and revenue [fol. 110] transactions under the method which the Commissioner intended or tried to impose upon the Association. The revenue would be expressed in the wrong rather than in the right way, would not be the correct amount of revenue earned.

Q. Would in your opinion the net worth of the Association on its balance sheets from year to year be overstated unless an account was established representing a liability or dues for which no services had been rendered as of the end of the year?

A. It would be overstated very substantially.

Q. If the Commissioner's method of accounting is successfully imposed would you state whether the American Automobile Association is paying taxes as it earns income or is prepaying them, or what?

A. Under the method which the Commissioner has prescribed for them they are definitely prepaying t[illegible]es on unearned income. In fact, they are prepaying taxes on advances which will never become income to the extent according to these exhibits, probably 98 per cent. In fact, I would say that the rough way of calculating the prepayment of taxes in the case of a motor club would be to take the going tax rate and apply it to the unearned membership dues outstanding as of a given period, because that has been taxed on the gross basis and will be consumed by the expenses which the Association is obligated to incur [fol. 111] in making the service available and for which the deduction will be available only against revenue from future membership for future periods to a very large extent.

Q. Mr. Bell, the testimony in this case is to the effect that Ernst & Ernst were independent auditors of the American Automobile Association from 1931 to 1957 and that the firm of Peat, Marwick, Mitchell & Company are now the independent auditors. Will you or your department be in charge of auditing the books and records of this Association in the future?

A. Yes, sir, I am directly responsible for this engagement and it is being performed right now under my supervision.

Q. Have you changed the method of accounting which has been used by the American Automobile Association?

A. No. We fully agree with the method, and, therefore, will raise no objections.

Q. Mr. Bell, would you certify to the accuracy of the income or profit and loss statement of the American Automobile Association if all advance dues must be reflected in income in the year's receipts?

A. No, we couldn't render an opinion on that. As you say "certify" we use the word "render an opinion." We could not render an opinion because it would not be a proper method of reflecting the income of the Association.

[fol. 112] Q. Would you render an opinion that the balance sheet properly presents the financial picture of the Association unless there were a liability account shown in the balance sheet for prepaid dues for which no services had yet been rendered?

A. No, we could not render an opinion on that because it would be misstating the financial position of the Association.

Mr. Bomar: Thank you, Mr. Bell.

Cross examination.

By Mr. Kane:

Q. I believe you testified, Mr. Bell, that you would not have any income, you would be taxing the gross receipts, is that right, in this case?

A. The effect would be taxing the gross receipts, that's right.

Mr. Kane: That is all.

Redirect examination.

By Mr. Bomar:

Q. How large is the accounting firm of Peat, Marwick, Mitchell & Company?

A. I believe we are the largest accounting firm in the world.

Q. How many offices do you have in the United States and elsewhere?

[fol. 113] A. Well, if my memory serves me correctly, we have fifty in the United States, twelve in Canada, fifteen in South America and sixty-eight elsewhere in the world.

Mr. Bomar: Thank you.

Mr. Kane: Let me ask you a quick question on the Michigan Club. Do you handle that account?

The Witness: No, I don't.

Mr. Kane: Thank you very much.

Commissioner Bennett: You are excused, Mr. Bell.

(Witness excused.)

Mr. Bomar: Mr. McAnly, please.

Whereupon—HERBERT T. MCANLY, a witness produced on behalf of the Plaintiff, being first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Bomar:

Q. Please state your full name and address for the record.

A. My name is Herbert T. McAnly. I live at 19101 Shelbourne Road, Shaker Heights, Cleveland, Ohio.

Q. What is your occupation, Mr. McAnly?

A. I am a Certified Public Accountant, a general partner in the firm of Ernst & Ernst. Presently from the operating [fol. 114] standpoint I function as the national director for our management services division. This division is an outgrowth of our former systems division founded more than fifty years ago, and the primary basic objective in the constructive work I do is dealing with companies in improving their systems in order to properly determine income.

Q. Mr. McAnly, you have stated that you are a Certified Public Accountant. In how many states are you licensed to practice as a Certified Public Accountant? In how many states do you have their certificate?

A. I got my original certificate in 1923 in the State of Indiana. In the last thirty-five years I have qualified and received certificates in twenty-four other states including the District of Columbia, and this includes all of the major states such as New York, California, Texas, Pennsylvania, Ohio and Illinois.

Q. Would you please describe your accounting experience? While you have referred to it I would ask that you please describe when you first came into the field and generally how you worked your way up.

Mr. Kane: Excuse me. If you want to shorten this procedure I will admit he is an expert.

The Witness: I will just answer one thing. I started in 1920 and this is finishing my 39th year. I have been [fol. 115] a partner since 1936, for the last 22 years.

Mr. Bomar: While I appreciate the offer to concede that my witness is an expert, in my opinion the degree of eminence of our experts is important in this case and I would ask that I be allowed to continue.

Commissioner Bennett: Do you have a memorandum on it?

Mr. Bomar: I do not.

Mr. Kane: I didn't mean to interrupt that. I was just making this statement, hoping to shorten it.

Mr. Bomar: I have just a few additional questions.

Commissioner Bennett: You are paying for the record. Go ahead.

Mr. Bomar: Would you please read the question and answer so far?

(Question and answer read.)

The Witness: I might add that I presently serve as a member of the five-man Managing Committee of the firm which sets the policies and controls the operations of the firm.

By Mr. Bomar:

Q. Are you a member or have you been a member of any of the committees of the American Institute of Accountants?

A. Yes, for the past six or seven years I have been a member of the Committee on National Defense, and I am now serving as chairman of that committee. The func-
[fol. 116] tion of that committee deals primarily with the development of acceptable accounting principles of suppliers in industry dealing with the Department of Defense, in determining net profit on contracts and Government business and so on.

I am also serving in the capacity as chairman on the Committee on Pricing and Military Accounting for the National Association of Manufacturers, and that committee functions somewhat in the same capacity except it represents an industry group rather than a professional accounting group.

Q. Are you the author of any articles in the field of accounting, or books?

A. Yes. I have written no complete books but over the years I had a great many articles published on various accounting subjects dealing primarily with accounting principles and cost accounting data.

Q. And in which publication would those articles appear?

A. Well, in the Journal of Accountancy, which is the official organ of the American Institute, and in The Controller, which is a national publication of the Controller's Institute and the official bulletin of the National Association of Accountants. It used to be called the National Association of Cost Accountants, but I have a list of those if you wish them.

[fol. 117] Q. Mr. McAnly, based on your many years of experience in the accounting field, would you please state your opinion as to whether or not the accounting method followed by the American Automobile Association with respect to the advance or prepaid dues is in conformity with generally accepted accounting principles?

A. Based upon experience and the things that we have been striving for in trying to determine or define what is proper net income, I believe that the methods employed,

recognizing advances as liabilities rather than income, is in accordance with sound accounting principles.

Q. And, Mr. McAnly, if the Association is compelled to determine its income in accordance with the method of accounting which the Commissioner seeks to impose upon the Association, would its income be fairly reflected in accordance with generally accepted accounting principles?

A. No, it would not be, because the liabilities would be understated and so-called profit overstated.

Q. Mr. McAnly, would you certify to the accuracy of the income or profit and loss statement of the American Automobile Association if the Association follows the method of accounting which the Commissioner seeks to impose upon it?

A. No, it would be impossible to express an opinion, if it is contrary to what you believe and what is accepted as general accounting principles.

[fol. 118] Q. And would the balance sheet of the American Automobile Association fairly reflect its financial position if dues for which no services have been rendered were not considered as a liability of the Association?

A. No, it would not unless the liabilities properly reflect it.

Q. Mr. McAnly, are there any parallel examples derived from your many years of experience as a Certified Public Accountant which might shed light on the accounting issue involved in this case?

A. I might say that the whole principle of accrued accounting embodies the necessity of setting up both assets and liabilities and getting away from using cash transactions as governing the determination of income. Specifically I can recall, for example, in small loan companies or companies that purchase installment commercial paper where a $500 loan is made in which the borrower receives $400, and in the accrued accounting there is a $500 asset due from the borrower.

The $100 which represents the discount and collection expense which has been collected in advance is always set up as a liability or deferred income and taken into income over the period of the loan in relation to the funds that are actually performing the work.

Now, in a sense that is somewhat the reverse of what [fol. 119] we have here, but the principle is the same. In fact, almost any transaction in business which determines income may or may not coincide with the receipt of cash. Actually if it does it is just a coincidence.

A store that has only cash sales would have gross revenue of sales which would agree with the cash receipts, but the completion of the transaction in business where a product is furnished results when the item is taken from inventory on the books and transferred to a receivable, at which time the gross profit is set up, and out of which comes the expenses for the current period.

It seems to me that the whole confusion in this case is trying to determine income from the receipt of cash, dealing with cash rather than taking into consideration the service which is being paid for. In fact, it is not an item that until it became an issue in the case that was referred to, and one or two others, that was ever considered a controversial item in accounting. It is just so obvious that it has been accepted as properly reflecting income by deferring and treating as a liability anything that is paid in advance whether it is a club, department store, or what.

I can just think of hundreds of situations that would point out that there never is any relationship between the receipt of cash. We even have in our defense work or [fol. 120] other construction work, for example, one of the methods of determining the net income is the so-called percentage of completion basis, and even there no attention is paid to the amount of cash that has been paid. It is the engineering determination of what has been completed, and at that time the inventory is taken from inventory and charged against the estimated revenue.

You know, years ago before we had to be so careful about the determination of income, before our Government takes more than half to start with, and accounting, as I understood—it was before my time—was in the affirmative stage. many attempts were made to judge the success of a business as to how much cash was in the bank. It soon became evident there were many other assets as well as liabilities that hadn't been paid, and as a result we have

what we call the accrued accounting method, and how cash paid in advance of a service can be construed as net income subject to tax is just inconceivable from my standpoint.

Mr. Bomar: Thank you, Mr. McAnly.

Mr. Kane: Having heard your opinion, I have no questions.

Commissioner Bennett: Thank you. You are excused.

(Witness excused.)

Mr. Bomar: Plaintiff rests, with one exception, that Plaintiff would be pleased to produce the entire record in [fol. 121] the Michigan case and have it added as a part of this record, certified to by the Clerk of the Tax Court if it is thought that that record would shed any light on the disposition of this case.

Commissioner Bennett: What does the Government think about that?

Mr. Kane: I don't believe that it would, Your Honor. I have been, like him, through the entire record, I think, and the opinions fairly reflect, I believe, what is actually in the record in this case.

Mr. Bomar: There was no accounting testimony of any description in the record, as I understand it. I would be delighted to stipulate with you that the portion of the record that deals with the subject, there were three issues in the case. The accounting issue is only one.

Mr. Kane: I don't know. I am willing to stipulate into the record any portions he feels are material and relevant. I frankly don't see it at the moment, but if he comes to see me and we sit down and discuss it I will certainly consider stipulating further.

Commissioner Bennett: If you do reach such a stipulation I will receive it even though we have the proof closed.

Mr. Kane: I would like, before we close proof, to ask Mr. Cooper one or two questions which I missed this [fol. 122] morning but didn't want to interrupt the expert to get them in.

Commissioner Bennett: Will you come back around, Mr. Cooper?

Whereupon—ARTHUR I. COOPER, a witness recalled on behalf of the Plaintiff, having been previously duly sworn by said Commissioner, was examined and testified further as follows:

Cross examination (Continued).

By Mr. Kane:

Q. I wanted to ask you first if you knew, Mr. Cooper, if the American Automobile Association had any policy of refunding membership dues.

A. I am not familiar with the policy, sir, since it varies in various divisions and is under the jurisdiction of the division managers, but I do know that such refunds are occasionally made, because I see the evidence of them in the ledger.

Q. Maybe this is not a fair question of you, Mr. Cooper, but do you know if the American Automobile Association have a policy of warning a person if he is taking too much service out at any given time, that unless it is cut down he will lose his membership?

A. I am not sure that I can answer that question. I do [fol. 123] know they will send out a notice to the effect that there may have been some excessive use of service, but it is more in the nature of advice to the member that perhaps there is some aspect of his car that needs attention, for example, that his battery needs to be replaced or something of that nature.

I am really not familiar with that, though.

Mr. Kane: I don't believe I have anything else. If we have missed anything I think I can assume Mr. Bomar will give me the same offer of stipulating it in, if it is a fact.

Commissioner Bennett: Do I understand, then, Mr. Kane, that the Government wishes to rest?

Mr. Kane: We would like to have this one leeway if we could, Your Honor, and that is I take it the record will not be closed for a week or two. If Your Honor would have no objection I would like the opportunity to review some of the schedules in some little detail to see if there is anything I feel should be refuted or explained in the record.

But I will not hold up the record any more than ten days or two weeks.

Mr. Bomar: We are very anxious to proceed with this case as quickly as possible. We believe that Mr. Kane should have any opportunity to verify any statistical data from our records which he doesn't think he has verified. [fol. 124] We will cooperate with him in every way to do so, but we are anxious that the matter be disposed of as promptly as possible.

Mr. Kane: We are, too, Your Honor, but I would like to have my agents go over these with me. If we feel we should produce another exhibit it probably would be through one of these revenue agents who has been up there, and this is the table that he made.

Commissioner Bennett: Gentlemen, the proof and rebuttal in this case will be marked closed when Mr. King files the transcript and the exhibits in the office of the clerk. If either counsel wishes to reopen the evidence you may make a motion directed to me showing cause for that and I will consider it and consult with you. I have already indicated that if you have any stipulation, however, that you wish to file, that may be automatically considered part of the record when it is filed with the clerk.

Now, after Mr. King, the reporter, files the transcript and exhibits your time will commence to run for the submission of requested findings of fact. The Plaintiff may have thirty days in which to submit those requests. If that proves to be inadequate for some reason you gentlemen foresee now, let me know and we will work it out.

Defendant's time will start from the time Plaintiff files its requests, and Defendant may have a similar amount of time, and thereafter Plaintiff may have 15 days in which [fol. 125] to comment upon the Defendant's requests if it so desires.

The hearing is closed.

(Whereupon, at 3:40 o'clock p.m., the hearing in the above-entitled matter was closed.)

[fol. 126]

Plaintiff's Exhibit 1

American Automobile Association

Year	Prepaid Dues Received	Deferred Revenue Membership Dues	Percentage
1949	$1,880,641.35	$ 941,976.79	50.1%
1950	2,165,392.96	1,082,393.51	50.0
1951	2,659,502.38	1,323,293.69	49.8
1952	3,160,288.18	1,562,042.23	49.4
1953	3,531,178.67	1,755,407.46	49.7

[fol. 127]

Plaintiff's Exhibit 2

American Automobile Association
Monthly Costs and Expenses
Five Years 1948-1952
(Divisions Only)

Month	Year 1948	1949	1950	1951	1952	Total 1948-1952	Monthly Percent
January	$ 115,837.69	$ 128,764.65	$ 142,957.00	$ 190,958.20	$ 246,135.35	$ 824,652.89	7.48%
February	127,002.09	131,498.47	147,461.00	181,479.00	235,698.03	823,138.59	7.47
March	137,192.11	145,219.23	161,796.00	227,269.00	269,488.00	940,964.34	8.54
April	143,210.62	156,504.80	172,344.00	221,452.00	279,446.00	972,957.42	8.83
May	150,091.89	156,045.54	175,622.00	231,375.00	275,607.00	988,741.43	8.97
June	138,012.68	177,026.02	203,742.00	247,466.00	229,502.00	995,748.70	9.03
July	151,565.00	14[illegible],247.00	160,671.29	223,864.00	296,972.00	981,319.29	8.90
August	127,425.00	144,244.00	168,332.29	230,628.94	274,641.00	945,271.23	8.58
September	126,169.00	139,755.00	163,636.00	208,164.00	261,025.00	898,749.00	8.15
October	112,935.00	134,298.00	170,050.29	217,942.00	268,777.00	904,002.29	8.20
November	111,483.00	121,949.00	161,524.29	193,040.00	244,807.00	832,803.29	7.56
December	146,870.79	114,592.56	184,330.07	240,758.82	226,969.83	913,522.07	8.29
Total	$1,587,794.87	$1,698,144.27	$2,012,466.23	$2,614,396.96	$3,109,068.21	$11,021,870.54	100.00%

[fol. 128]

Plaintiff's Exhibit 3

American Automobile Association
Deferred Revenue—Membership Dues at December 31, 1953
Based on Cost Percentages for Five Years 1948-1952

Month	Prepaid Dues Received	7.48% January	7.47% February	8.54% March	8.83% April	8.97% May	9.03% June	8.90% July	8.58% August	8.15% September	8.20% October	7.56% November	8.29% December	
January	$ 257,698.02	$ 9,637.90	$19,250.04	$22,007.41	$22,754.74	$ 23,115.51	$ 23,270.13	$ 22,935.12	$ 22,110.49	$ 21,002.39	$ 21,131.24	$ 19,481.97	$ 21,363.17	$
February	236,610.67		8,837.41	20,206.55	20,892.72	21,223.98	21,365.94	21,058.35	20,301.20	19,283.77	19,402.07	17,887.77	19,615.02	
March	282,430.08			12,059.76	24,938.58	25,333.98	25,503.44	25,136.28	24,232.50	23,018.05	23,159.27	21,351.71	23,413.45	
April	296,647.02				13,096.96	26,609.24	26,787.23	26,401.58	25,452.31	24,176.73	24,325.06	22,426.51	24,592.04	
May	328,191.75					14,719.40	29,635.72	29,209.07	28,158.85	26,747.63	26,911.72	24,811.30	27,207.10	
June	378,716.30						17,099.04	33,705.75	32,493.86	30,865.38	31,054.74	28,630.95	31,395.58	
July	386,150.87							17,183.71	33,131.74	31,471.30	31,664.37	29,193.01	32,011.91	
August	336,269.66								14,425.97	27,405.98	27,574.11	25,421.99	27,876.75	
September	275,235.54									11,215.85	22,569.31	20,807.81	22,817.03	
October	268,661.48										11,015.12	20,310.81	22,272.04	
November	219,278.02											8,288.71	18,178.15	
December	265,289.26												10,996.24	
Total	$3,531,178.67	$ 9,637.90	$28,087.45	$54,273.72	$81,683.00	$111,002.11	$143,661.50	$175,629.86	$200,306.92	$215,187.08	$238,807.01	$238,612.54	$281,738.48	$

8.20% October	7.56% November	8.29% December	1953 Dues Income in 1953	1953 Dues Deferred at Dec. 31, 1953
$ 21,131.24	$ 19,481.97	$ 21,363.17	$ 248,060.11	$ 9,637.91
19,402.07	17,887.77	19,615.02	210,074.78	26,535.89
23,159.27	21,351.71	23,413.45	228,147.02	54,283.06
24,325.06	22,426.51	24,592.04	213,867.66	82,779.36
26,911.72	24,811.30	27,207.10	207,400.79	120,790.96
31,054.74	28,630.95	31,395.58	205,245.30	173,471.00
31,664.37	29,193.01	32,011.91	174,656.04	211,494.83
27,574.11	25,421.99	27,876.75	122,704.80	213,564.86
22,569.31	20,807.81	22,817.03	77,410.00	197,825.54
11,015.12	20,310.81	22,272.04	53,597.97	215,063.51
	8,288.71	18,178.15	26,466.86	192,811.16
		10,996.24	10,996.24	254,293.02
$238,807.01	$238,612.54	$281,738.48	$1,778,627.57	$1,752,551.10

[fol. 129]

PLAINTIFF'S EXHIBIT 4

AMERICAN AUTOMOBILE ASSOCIATION
MONTHLY COSTS AND EXPENSES
FIVE YEARS 1949-1953
(DIVISIONS ONLY)

Month	Year 1949	1950	1951	1952	1953	Total 1949-1953	Monthly Percent
January	$ 128,764.65	$ 142,957.00	$ 190,958.20	$ 246,135.35	$ 246,597.00	$ 955,412.20	7.46%
February	131,498.47	147,461.00	181,479.00	235,698.03	244,880.00	941,016.50	7.34
March	145,219.23	161,796.00	227,269.00	269,488.00	277,106.00	1,080,878.23	8.44
April	156,504.80	172,344.00	221,452.00	279,446.00	299,836.00	1,129,582.80	8.82
May	156,045.54	175,622.00	231,375.00	275,607.00	292,811.00	1,131,460.54	8.83
June	177,026.02	203,742.00	247,466.00	229,502.00	304,527.00	1,162,263.02	9.07
July	148,247.00	160,671.29	223,864.00	296,972.00	314,934.00	1,144,688.29	8.93
August	144,244.00	168,332.29	230,628.94	274,641.00	292,587.00	1,110,433.23	8.67
September	139,755.00	163,636.00	208,164.00	261,025.00	285,419.00	1,057,999.00	8.26
October	134,298.00	170,050.29	217,942.00	268,777.00	288,170.00	1,079,237.29	8.42
November	121,949.00	161,524.29	193,040.00	244,807.00	258,780.00	980,100.29	7.65
December	114,592.56	184,330.07	240,758.82	226,969.83	271,742.91	1,038,394.19	8.11
Total	$1,698,144.27	$2,012,466.23	$2,614,396.96	$3,109,068.21	$3,377,389.91	$12,811,465.58	100.00%

[fol. 130]

Plaintiff's Exhibit 5

American Automobile Association
Deferred Revenue—Membership Dues at December 31, 1954
Based on Cost Percentages for Five Years 1949-1953

Month	Prepaid Dues Received	7.46% January	7.34% February	8.44% March	8.82% April	8.83% May	9.07% June	8.93% July	8.67% August	8.26% September	8.42% October	7.65% November	8.11% December	
January	$ 290,764.23	$10,845.50	$21,342.09	$24,540.50	$25,645.41	$ 25,674.48	$ 26,372.32	$ 25,965.25	$ 25,209.26	$ 24,017.13	$ 24,482.35	$ 22,243.46	$ 23,580.98	$
February	284,319.95		10,434.54	23,996.60	25,077.02	25,105.45	25,787.82	25,389.77	24,650.54	23,484.83	23,939.74	21,750.48	23,058.35	
March	351,697.47			14,841.63	31,019.72	31,054.89	31,898.96	31,406.58	30,492.17	29,050.21	29,612.93	26,904.86	28,522.66	
April	329,066.99				14,511.86	29,056.62	29,846.38	29,385.68	28,530.11	27,180.93	27,707.44	25,173.62	26,687.33	
May	382,385.38					16,882.32	34,682.35	34,147.01	33,152.81	31,585.03	32,196.85	29,252.48	31,011.45	
June	451,260.81						20,464.68	40,297.60	39,124.31	37,274.14	37,996.16	34,521.45	36,597.25	
July	435,832.93							19,459.94	37,786.72	35,999.80	36,697.13	33,341.22	35,346.05	
August	395,009.70								17,123.66	32,627.80	33,259.82	30,218.24	32,035.29	
September	260,950.54									10,777.26	21,972.04	19,962.72	21,163.09	
October	309,543.51										13,031.78	23,680.08	25,103.98	
November	279,144.44											10,677.28	22,638.61	
December	308,553.22												12,511.84	
Total	$4,078,529.17	$10,845.50	$31,776.63	$63,378.73	$96,254.01	$127,773.76	$169,052.51	$206,051.83	$236,069.58	$251,997.13	$280,896.24	$277,725.89	$318,256.88	$2

8.42% October	7.65% November	8.11% December	1954 Dues Income in 1954	1954 Dues Deferred at Dec. 31, 1954
$ 24,482.35	$ 22,243.46	$ 23,580.98	$ 279,918.73	$ 10,845.50
23,939.74	21,750.48	23,058.35	252,675.14	31,644.81
29,612.93	26,904.86	28,522.66	284,804.61	66,892.86
27,707.44	25,173.62	26,687.33	238,079.97	90,987.02
32,196.85	29,252.48	31,011.45	242,910.30	139,475.08
37,996.16	34,521.45	36,597.25	246,275.59	204,985.22
36,697.13	33,341.22	35,346.05	198,630.86	237,202.07
33,259.82	30,218.24	32,035.29	145,264.81	249,744.89
21,972.04	19,962.72	21,163.09	73,875.11	187,075.43
13,031.78	23,680.08	25,103.98	61,815.84	247,727.67
	10,677.28	22,638.61	33,315.89	245,828.55
		12,511.84	12,511.84	296,041.38
$280,896.24	$277,725.89	$318,256.88	$2,070,078.69	$2,008,450.48

AMERICAN AUTOMOBILE ASSOCIATION
YEAR 1953
DEFERRED REVENUE—MEMBERSHIP DUES
BASED ON AVERAGE MONTHLY COSTS PER MEMBER

Month	Membership	Cost	Cost per Member	Percent	Percent Deferred	Prepaid Membership Dues	12/31/53 Deferred Membership Dues
January	220,435	$ 246,597.00	$ 1.12	7.71%	3.86%	$ 257,698.02	$ 9,947.14
February	223,040	244,880.00	1.10	7.57	11.50	236,610.67	27,210.23
March	224,170	277,106.00	1.24	8.52	19.55	282,430.08	55,215.08
April	226,034	299,836.00	1.32	9.15	28.38	296,647.02	84,188.42
May	228,453	292,811.00	1.28	8.84	37.38	328,191.75	122,678.08
June	230,190	304,527.00	1.32	9.12	46.36	378,716.30	175,572.88
July	233,953	314,934.00	1.35	9.28	55.56	386,150.87	214,545.42
August	236,997	292,587.00	1.23	8.52	64.46	336,269.66	216,759.42
September	239,650	285,419.00	1.19	8.22	72.82	275,235.54	200,426.52
October	242,656	288,170.00	1.19	8.19	81.03	268,661.48	217,696.40
November	244,910	258,780.00	1.06	7.29	88.77	219,278.02	194,653.10
December	246,856	271,742.91	1.10	7.59	96.20	265,289.26	255,208.27
Total	2,797,344	$3,377,389.91	$14.50	100.00%		$3,531,178.67	$1,774,100.96

Prepaid membership dues—1953	$3,531,178.67
Deferred membership dues 12/31/53	1,774,100.9
Membership dues income 1953	$1,757,077.71

[fol. 132] PLAINTIFF'S EXHIBIT 7 86

AMERICAN AUTOMOBILE ASSOCIATION
YEAR 1954
DEFERRED REVENUE—MEMBERSHIP DUES
BASED ON AVERAGE MONTHLY COSTS PER MEMBER

Month	Membership	Cost	Cost per Member	Percent	Percent Deferred	Prepaid Membership Dues	12/31/54 Deferred Membership Dues
January	249,805	$ 280,200	$ 1.12	7.62%	3.81%	$ 290,764.23	$ 11,078
February	252,169	320,193	1.27	8.62	11.93	284,319.95	33,919
March	255,416	348,615	1.37	9.27	20.87	351,697.47	73,399
April	260,795	323,123	1.24	8.41	29.71	329,066.99	97,766
May	263,793	356,652	1.35	9.18	38.51	382,385.38	147,256
June	268,084	377,373	1.41	9.56	47.88	451,260.81	216,063
July	274,467	368,511	1.34	9.12	57.22	435,832.93	249,383
August	279,147	345,792	1.24	8.41	65.98	395,009.70	260,627
September	284,081	341,600	1.20	8.16	74.27	260,950.54	193,808
October	288,222	337,271	1.17	7.95	82.44	309,543.51	255,187
November	291,477	321,321	1.10	7.49	90.04	279,144.44	251,341
December	295,889	270,417	.91	6.21	96.89	308,553.22	298,957
Total	3,263,345	$3,991,068	$14.72	100.00%		$4,078,529.17	$2,088,784

Prepaid membership dues—1954 **$4,078,529**
Deferred membership dues, 12/31/54 [illegible]

[fol. 133]

PLAINTIFF'S EXHIBIT 8

WILLIAM A. PATON
2203 Hill Street, Ann Arbor, Michigan

DATA REGARDING TRAINING AND EXPERIENCE

Educational Background (including technical certificate and honorary degree):

1. Undergraduate work was taken at Michigan State Normal College and University of Michigan.
2. Graduate work at University of Michigan. Received A.M. in 1916 and Ph.D in Economics in 1917. Doctoral dissertation was "Accounting Theory—with Special Reference to Corporate Form of Enterprise".
3. Holds C.P.A. certificate, issued by State of Michigan.
4. Received degree of doctor of letters (Litt.D.) at Lehigh University in 1944.

Teaching Appointments:

1. With minor interruptions has been on faculty at University of Michigan since 1914; was made full professor in 1921.
2. Instructor in economics at University of Minnesota, 1916-17.
3. Visiting professor, University of Chicago, summer of 1924.
4. Visiting professor, University of California, summer of 1921, and academic year 1937-38.
5. Dickinson lecturer, Harvard University Graduate School of Business Administration, April, 1940.
6. Lecturer, Case Institute of Technology, Economics-in-Action Program, July, 1952.
7. Lecturer, Public Utility Executive Program, University of Michigan, summers of 1951-1957.

Prepaid membership dues—1954 $4,078,529
Deferred membership dues 12/31/54 2,085,784

Present Position:

Professor of Economics, College of Literature, Science and the Arts, and Edwin Francis Gay University Professor of Accounting, School of Business Administration, University of Michigan, Ann Arbor, Michigan.

Writing:

1. Books and monographs—

Accountants' Handbook (editor and principal contributor, 1932 and 1943 editions), Ronald Press Co.

Principles of Accounting (with R. A. Stevenson), 1918, Macmillan Co.

Accounting Theory, 1922, Ronald Press Co.

Accounting, 1924, Macmillan Co.

Corporate Profits as Shown by Audit Reports, 1935, National Bureau of Economic Research

Essentials of Accounting, 1938, Macmillan Co.

Advanced Accounting, 1941, Macmillan Co.

Introduction to Corporate Accounting Standards (with A. C. Littleton), 1940, American Accounting Association.

Dickinson Lectures in Accounting (with Sir Laurence Halsey and George O. May), 1941, Harvard University Press.

Contemporary Accounting (with others), 1945, American Institute of Accountants

Asset Accounting (with W.A. Paton, Jr.), 1952, Macmillan Co.

Shirtsleeve Economics, 1952, Appleton-Century-Crofts.

Corporation Accounts and Statements (with W.A. Paton, Jr.), 1955, Macmillan Co.

[fol. 134] Economic Position of United Kingdom, 1919, U. S. Department of Commerce

Requisitioning of the Dutch Shipping, 1919, U. S. War Trade Board

Japanese Steel and Shipping Negotiations, 1919, U. S. War Trade Board

Rationing Agreement with Norway. 1919, U. S. War Trade Board

Trade and Shipping Negotiations with Spain, 1919, U. S. War Trade Board

Rationing and Shipping Negotiations with Sweded, 1919, U. S. War Trade Board

Also numerous problem and case books designed solely for classroom purposes.

2. Articles—

Severity of Trade Cycle in America. In W.H. Hamilton's "Current Economic Problems," 1919.

Theory of the Double-Entry System. Journal of Accountancy, 1917.

Significance and Treatment of Appreciation in the Accounts. Michigan Academy of Science, 1919.

Some Phases of Capital Stock. Journal of Accountancy, 1919.

Transactions Between Partner and Firm. Journal of Accountancy, 1919.

Proprietors' Salaries. Journal of Political Economy, 1920.

Some Current Valuation Accounts. Journal of Accountancy, 1920.

Depreciation, Appreciation, and Productive Capacity. Journal of Accountancy, 1920.

The Drug Store's Overhead. American Druggist, 1920.

Interest During Construction. Journal of Political Economy, 1920.

Methods of Measuring Business Income. Administration, 1921.

Assumptions of the Accountant. Administration, 1921.

The Pro and Con of a Sales Tax. Administration, 1921.

Inventory Valuation. Administration, 1922.

Dividends in Securities. Administration, 1922.

Accounting Training and Economics. Commerce and Administration (University of Chicago), 1922.

Educational Value of Training in Accounting. Papers and Proceedings of American Association of University Instructors in Accounting, 1923.

Simplification of Federal Income Taxation. Certified Public Accountant, 1923.

Tendencies in Accounting Literature. Papers and Proceedings of American Association of University Instructors in Accounting, 1925.

Contribution to Symposium of Opinions on Debt Settlement. American Accountant, 1927.

Distribution Costs and Inventory Values. Accounting Review, 1927.

Accrued Depreciation on Seasoned Properties. Certified Public Accountant, 1927.

Limitations of Financial and Operating Ratios. Accounting Review, 1928.

Special Applications of Discounting. Journal of Accountancy, 1928.

The Work in Accounting at Michigan. American Accountant, 1929.

The Dividend Code. Accounting Review, 1929.

Depreciation and Its Relation to Public Utilities. Accounting Review, 1930.

Economic Theory in Relation to Accounting Valuations. Accounting Review, 1931.

Accounting Problems of the Depression. Accounting Review, 1932.

Working Capital in Public Utility Regulation. Journal of Accountancy, 1932.

"Shoestring" Banking. Certified Public Accountant, 1933.

Shortcomings of Present-Day Financial Statements. Journal of Accountancy, 1934.

Aspects of Asset Valuations. Accounting Review, 1934.

Public Ownership. Public Service Magazine, 1934.

Costs and Profits in Present-Day Accounting. N.A.C.A. Bulletin, 1934.

Valuation of the Business Enterprise. Accounting Review, 1936.

Presentation of Bond Discount. Accounting Review, 1937.

[fol. 135] Comments on "A Statement of Accounting Principles." Journal of Accountancy, 1938.

Is it Desirable to Distinguish Between Various Kinds of Surplus? Journal of Accountancy, 1938.

The Gross Profit Convention. Accounting Forum, 1938.

Deferred Charges and Prepaid Expenses. American Institute of Accountants, 1938.

Objectives of Accounting Research. American Institute of Accountants, 1939.

Recording Revenue on Other Bases than Sales. Accounting Ledger, 1939.

Income and the Inventory Problem. Proceedings of Dedication of Vincent Hall, University of Minnesota, 1939.

Accounting Reports. Institute on Accounting, Ohio State University, 1940.

Last in, First out. Journal of Accountancy, 1940.

Basic Concepts of Property Accounting. Edison Electric Institute Bulletin, 1941.

The Cost Approach to Inventories, Journal of Accountancy, 1941.

Comments on the Cost Principle. Accounting Review, 1942.

Accounting. In Encyclopedia Americana, 1942.

Adaptation of Income Statement to Present Conditions. Journal of Accountancy, 1943.

Classification and Sequences in Financial Statements. American Institute of Accountants, 1943.

Simplification of Federal Tax Administration. Accounting Review, 1944.

Accounting Policies of the Federal Power Commission—A Critique. Journal of Accountancy, 1944.

Responsibilities and Training of the Postwar Accountant. Institute on Accounting, Ohio State University, 1944.

Modern Reports to Stockholders. Controllers Institute of America, 1944.

Transactions Between Affiliates. Accounting Review, 1945.

Current Economic Fallacies. Commercial and Financial Chronicle, 1945.

Accounting Policies and Management. Illinois Society of Certified Public Accountants, 1946.

Cost and Value in Accounting. Journal of Accountancy, 1946.

The Queue Society—Do We Want It? Michigan Alumnus Quarterly Review, 1947.

Restoration of Fixed Assets to the Balance Sheet. Accounting Review, 1947.

What is Actual Cost in Depreciation Accounting? Journal of Accountancy, 1948.

The Accountant and Private Enterprise, Journal of Accountancy, 1948.

Accounting Procedures and Private Enterprise. Journal of Accountancy, 1948.

Depreciation and the Price Level. Accounting Review, 1948.

Some Comments on Group and Sectional Interests. Michigan Alumnus Quarterly Review, 1948.

The Basis for Adequate Financial Reporting. American Management Association, 1948.

Analysis of Financial Statements. Cost and Management, Society of Industrial and Cost Accountants of Canada, 1948.

Why Corporate Profits are Overstated. Commercial and Financial Chronicle, 1948.

Lack of Venture Capital. National Savings and Loan Journal, 1949.

Accounting Problems Relating to Reporting of Profits. Economics and Business Foundation, 1949.

1948 Revision of American Accounting Association's Statement of Principles—Comments on Item 5 under "Expense". Accounting Review, 1949.

The Semantics of Annual Reporting. Annual Report Forum, University of Michigan, 1949.

Measuring Profits under Inflation Conditions. Journal of Accountancy, 1950.

[fol. 136] Overstatement and Misrepresentation of Corporate Earnings under Current Conditions. Republic Steel Corporation, 1952.

Use of Accounting Data in Economic Analysis. Institute on Accounting, University of Kentucky, 1950.

Economic and Accounting Aspects of Pension Plans. Accountants Graduate Study Conference, University of Michigan, 1950.

How Have Stockholders Been Faring? Michigan Business Review, 1952.

The Curb to Public Spending—There's no Such Thing as a Free Lunch. Public Service Magazine, 1953.

Utility Rates Must Recognize Dollar Depreciation (with Howard C. Greer). Public Utilities Fortnightly, 1953.

Premature Revenue Recognition. Journal of Accountancy, 1953.

The Depreciation Deduction—A Neglected Aspect. Michigan Business Review, 1953.

Significance of Depreciation Accounting with Special Reference to Plant Replacements. In Federal Tax Policy for Economic Growth and Stability, Joint Committee on the Economic Report, 1955.

3. Book Reviews—Has written between thirty and forty reviews which have appeared in such publications as Journal of Accountancy, Journal of American Statistical Association, Journal of Political Economy, American Economic Review, Accounting Review, etc.

Addresses:

Has given over 300 addresses before: (1) professional and scientific associations such as American Accounting Association, American Statistical Association, American Economic Association, American Institute of Accountants, Controllers' Institute, Cost Accountants, etc.; (2) trade association meetings, specific company groups, and other business conferences; (3) to civic, church, school and related organizations.

Memberships:

1. Scientific and professional—American Economic Association; American Accounting Association (pres., 1922); Michigan Association of Certified Public Accountants; American Institute of Accountants (member of Council, 1935-37, and member of Committee on Accounting Procedure, 1939-50); National Association of Cost Accountants; American Academy of Arts and Sciences (fellow); Michigan Academy of Science.
2. Honorary—Phi Beta Kappa; Beta Gamma Sigma; Phi Kappa Phi; Alpha Kappa Psi; Beta Alpha Psi.
3. Trustee, Foundation for Economic Education, Inc.
4. Trustee, Earhart Foundation.
5. Ohio State University "Accounting Hall of Fame" (one of three elected in 1950, when this honorary roster was established.

Professional and Business Experience:

1. Trade expert, U. S. War Trade Board, 1918.
2. Chief, Special Assignment Section, Income Tax Unit, U. S. Treasury Department, 1919.
3. Member of firm of Paton & Ross, Certified Public Accountants, Ann Arbor, Michigan, 1926-1936.
4. Director, Kalamazoo Vegetable Parchmant Co., 1952 to date.

[fol. 137] 5. Consultant and expert witness in numerous industrial and public utility rate cases, hearings, and investigations, over a period of forty years. Following is a partial list of such engagements:

Assisted in survey of income accounting of several Michigan electric power companies, 1914-15.

Consultation on values, income, labor costs, etc. for the Detroit United Railways, 1920.

In charge of accounting work in connection with valuation of Kansas City Railways Co. and predecessor companies for United States Court, 1924-25.

Accounting study of Community Traction Company, Toledo, for City of Toledo; also study of plant account for the Company, 1926.

Study of income accounting, with emphasis on depreciation, of Grand Rapids, Grand Haven, and Muskegon Railway Co., and testimony thereon in United States Court, for the receivers, 1927.

Installation of accounting system for electric and water departments of City of Wyandotte, Michigan, 1928.

Study of depreciation accounting of New York Telephone Company, and testimony thereon before the New York Public Service Commission, for the Commission, 1929.

Determination of operating revenues and expenses of International Railway Company applicable to City of Buffalo, and testimony thereon before master in United States Court, for the City of Buffalo, 1929-30.

Study of problem of required working capital and other problems in connection case involving Alabama Power Co., 1930.

Testimony before Committee on Ways and Means, Washington, D.C., on jurisdiction of Board of Tax Appeals in special assessment cases, 1932.

Survey of accounting problems of Board of Road Commissioners of Wayne County, Michigan, 1933.

Study of rate of return in connection with Michigan Bell Telephone case, and testimony thereon before

master in United States Court, for the Michigan Commission, 1932.

Special investigation of revenues and expenses of Kansas City Public Service Company, and testimony thereon before Missouri Commission, for City of Kansas City, Missouri, 1930.

Testimony on price determination under depression conditions, and problems of property revaluation, before the Wisconsin Public Service Commission, for the Commission, on statewide Wisconsin Telephone Company case, 1932.

Compilation of historical cost of property for the Ohio-Edison Co., for Company, in connection with City of Akron rate case before Ohio Public Service Commission, 1932.

Study of earnings and financial ratios of approximately 700 companies, mostly small and medium-sized concerns, for National Bureau of Economic Research, summers of 1931-33.

[fol. 138] Survey of accounting system of State of Michigan for special committee of State Legislature, 1933.

Testimony on joint costs before Michigan Commission, for the Commission, rate case involving Michigan Bell Telephone Co., 1933.

Preparation of financial survey of operations of Tennessee Valley Authority for Arthur Morgan, 1938.

Preparation of memorandum regarding "original cost" for Long Island Lighting Company, 1940.

Testimony on goodwill and fair return before Louisville Court in case involving O'Brien tobacco company, for Mrs. J. A. O'Brien, 1940.

Testimony before an examiner of Securities and Exchange Commission in Washington on treatment of cost of subsidiary stock in the event of merger, for Northern States Power Company, 1941.

Testimony before an examiner of Federal Power Commission, in Madison, Wisconsin, regarding profits of affiliates, intangible assets, and other matters, for St.

Croix Falls, Wisconsin, Improvement Co. and St. Croix Falls, Minnesota, Improvement Co., 1941.

Study of fair rate of return of subsidiary company relative to terms of contract between subsidiary and parent, for Procter & Gamble Co., 1942.

Testimony before an examiner of Federal Power Commission in San Francisco regarding service charges to affiliates, intangibles, and depreciation, for the California-Oregon Power Company, in 1942.

Testimony before a hearing of the Federal Communications Commission in Chicago, on the subject of joint costs, for the City of Detroit, 1942.

Testimony before an examiner of the Securities and Exchange Commission in Philadelphia, on property costs, depreciation, preferred dividend arrearages, etc., for Central Illinois Public Service Co., in 1942.

Study of the earning power of American Power & Light Co. and testimony thereon in hearing before an examiner of the Securities and Exchange Commission in Philadelphia in 1943 and 1944.

Testimony before a joint hearing of the Federal Power Commission and Montana Public Service Commission, in Butte, Montana, regarding property costs, intangibles, and other matters, for the Montana Power Co., in 1944.

Testimony (by deposition) before the Arkansas Department of Public Utilities, regarding property cost, intangibles, depreciation, etc., for the Arkansas Power and Light Co., 1944.

Testimony before an examiner of Securities and Exchange Commission in Philadelphia regarding various accounting practices of Transamerica Corporation, and affiliated companies, for the Corporation, in 1944.

Testimony in a rate hearing before the Public Service Commission of Maryland for the Consolidated Gas Electric Light and Power Company of Baltimore, in Baltimore, regarding classification of property costs, intangibles, quasi reorganization, and other questions, 1945.

[fol. 139] Testimony regarding intangibles, conflicts of regulatory authority, and other matters relating to the affairs of the Arkansas Power & Light Co. before an examiner of the Federal Power Commission in Washington, for the Company, 1948.

Testimony before subcommittee on profits of Joing Committee on the Economic Report regarding effect of inflation and taxes on corporate earnings and position of risk capital, on behalf of American Institute of Accountants, 1948.

Testimony regarding rate of return and related questions for the Consumers power Co. before the Michigan Public Service Co., 1949.

Statement regarding effect of inflation on depreciation and corporate earnings before Presidential Steel Board, on behalf of Republic Steel Co., in 1949, and statement on the same subjects to the Steel Panel of the Wage Stabilization Board, in 1952.

Testimony before Federal Court in Toledo regarding value of the stock of the Fourco Glass Co. on behalf of Blackford Window Glass Co., in 1951.

Testimony before Illinois Commerce Commission in Chicago on the impact of the change in the value of the dollar on the measurement of depreciation cost, on behalf of Peoples Gas, Light & Coke Co., 1952.

Statement to City Council of Dallas, Texas, regarding relation of accounting to rate regulation and the effect of inflation on measurement of costs, on behalf of Southwestern Bell Telephone Co,, 1952.

Statement before Ways and Means Committee, U.S. Congress, regarding measurement of depreciation deduction for tax purposes, 1953.

Testimony before Illinois Commerce Commission regarding effect of inflation on measurement of cost and income, on behalf of Illinois Power Co., 1954.

Panelist for Subcommittee and Tax Policy, Joint Committee on the Economic Report, U. S. Congress, 1955.

Consultant and member of Academic Committee, Advanced Training Center of Internal Revenue Service, 1955-56.

Testimony before Indiana Public Service Commission regarding measurement of depreciation cost, on behalf of Indiana Telephone Corporation, 1956.

Statements to House Post Office and Civil Service re costs of postal operations, in 1956-57.

Testimony for Missouri Water Co. before Missouri Public Service Commission regarding effect of inflation on measurement of cost and income, 1956.

Testimony on effect of inflation on financial measurement before City Council of Jackson, Mississippi, on behalf of Mississippi Valley Gas Co., 1956.

[fol. 140]

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1960

No. 288

AMERICAN AUTOMOBILE ASSOCIATION, Petitioner

v.

UNITED STATES OF AMERICA

CROSS-DESIGNATION OF RECORD FOR PRINTING—
Filed November 21, 1960

The United States cross-designates the following parts of the record in addition to those parts which have been designated by the petitioner:

1. The entire transcript of "Testimony for Plaintiff", except for the testimony of William A. Paton which has already been certified and printed.

2. Plaintiff's exhibits Nos. 1 through 8 (as listed on page ii of the index to "Testimony for Plaintiff").

The above items are parts of the original record in the Court of Claims not previously certified to this Court. The

United States, without objection by petitioner, has moved the Court of Claims to so certify them. In requesting that the above items be permitted in this cross-designation, even though the time for filing such cross-designation has heretofore expired on October 24, 1960, we are authorized to inform this Court that petitioner has no objection to inclusion of these materials in the printed record.

Plaintiff's Exhibit 9 in the Court of Claims contained all relevant parts of the Record in the Tax Court of the United States on the issue of the proper accounting for prepaid [fol. 141] membership dues in *Automobile Club of Michigan* v. *Commissioner*, which was appealed to this Court and reported in 353 U.S. 180, rehearing denied, 353 U.S. 989 (No. 89, Oct. Term 1956). Since the entire record in that case is on file in this Court, the parties have agreed not to reprint plaintiff's Exhibit 9. The parties agree, however, that either or both of them may refer to any part of such record in their briefs and arguments in the present case.

J. Lee Rankin, Solicitor General.

No Objection

Fleming Bomar, Attorney for Petitioner.